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MARITIME APPROPRIATION AUTHORIZATION ACT FOR FISCAL YEAR 1986

HEARING

BEFORE THE

SUBCOMMITTEE ON MERCHANT MARINE

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

S. 102

TO AUTHORIZE APPROPRIATIONS FOR THE MARITIME CONSTRUCTION DIFFERENTIAL SUBSIDY FOR FISCAL YEAR 1986, TO PROMOTE A STRONG UNITED STATES MERCHANT MARINE, AND FOR OTHER PURPOSES

S. 679

TO AUTHORIZE THE APPROPRIATION OF FUNDS FOR CERTAIN MARITIME PROGRAMS FOR FISCAL YEAR 1986

MARCH 21 AND 29, 1985

Printed for the use of the
Committee on Commerce, Science, and Transportation

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MARITIME APPROPRIATION AUTHORIZATION ACT FOR FISCAL YEAR 1986

THURSDAY, MARCH 21, 1985

U.S. Senate,
Committee on Commerce, Science and Transportation,
Subcommittee on Merchant Marine,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room SD-628, Dirksen Senate Office Building, Hon. Ted Stevens (chairman of the subcommittee) presiding.

Staff members assigned to these hearings: David Dye, staff counsel, and John D. Hardy, minority staff counsel.

OPENING STATEMENT BY SENATOR STEVENS

Senator Stevens. Good morning.

The Merchant Marine Subcommittee is meeting today to take testimony on S. 679, which is the maritime authorization for the fiscal year 1986, and S. 102, a bill to authorize funding for the construction differential subsidy.

S. 679 is generally consistent with the administration's budget for maritime programs, with three exceptions.

First, it does not include savings that require program changes by regulation or legislation.

Second, it includes funding for fuel oil for State academy training ships.

Third, it funds Federal salaries at existing levels.

In other words, the administration's budget of $377.2 million is increased to $417 million by this bill. Even with this increase, the bill represents a $48.2 million or 10 percent decrease from last year's appropriation level.

The operating differential subsidy is authorized at $335.1 million. The authorization covers existing subsidy contracts only and would provide for ongoing support of 91 liner and 17 bulk vessels. There is no funding for settlement and termination of contracts.

The administration's budget request of $299.5 million for ODS assumes a $35.6 million savings resulting from the elimination of the "double subsidy" in the payment of ODS on vessels carrying military or premium-rated civilian preference cargos, changes in the method of computing the scope of foreign competition, and easing essential service trade route rules. The ODS program must be modified either by regulation or legislation to achieve these savings. Since neither process has been initiated, S. 679 does not include those projected savings.

Maritime research and development activities are authorized in the bill at $9.9 million. This is a freeze from last year's appropriation level and reflects the decreased emphasis on applied research which began last year.

The remaining $72 million, $5.5 million less than last year's appropriation, is authorized for maritime operations and training. This category includes, among other things, funding for the U.S. Merchant Marine Academy, the six State academies, support of the National Defense Reserve Fleet, and emergency planning.

As in last year's authorization, $3 million was added for the purchase of fuel oil for State academy training vessels. In addition, the bill funds salaries for MarAd employees at existing wage scales.

Finally, the bill before us authorizes activities of the FMC at the administration's requested level of $11.6 million plus full funding for FMC employee pay, for a total of $11.9 million. This is a decrease of $352,000 from last year's appropriation.

S. 102 is Senator Inouye's and Senator Long's bill to authorize $300 million for CDS for 1986. The bill would also raise the maximum subsidy from 50 percent to 60 percent. In addition, the bill would raise the limit on outstanding commitments and guarantees under title XI loan guarantees from $12 billion to $15 billion. The administration has not requested funding of CDS for the last 5 years, nor has it requested an increase in the title XI limit.

This year, OMB has proposed increasing user fees on a variety of loan guarantee programs. For title XI, this would include increasing the present annual loan guarantee to 1 percent, and imposition of an up-front 5 percent fee on new loan guarantees and advances. We have serious concerns about the way these proposed increases would affect the program. We need to be very careful that we do not unintentionally destroy title XI by pricing potential users out of the market.

Last year I spoke several times about the divisiveness that is rampant in this industry. While we still have a long way to go, I think we are all pleased to see that the industry has begun an internal dialog to attempt to come to a common understanding and to a unified approach to many of the problems which face the industry as a whole.

I would like to note that the statements of the Joint Maritime Congress, the Military Sealift Command, and Matson Navigation will be included in the record at an appropriate spot.

Senator Gorton, do you have an opening comment?

Senator **GORTON**. I have no opening statement.

Senator **STEVENS**. Senator Inouye, do you have an opening statement?

OPENING STATEMENT BY SENATOR INOUYE

Senator **INOUYE**. Thank you Senator Stevens.

The history of the U.S. merchant marine since World War II has been one of steady decline. At the end of World War II our merchant fleet was unrivaled; today it ranks 11th.

Some of the recent statistics I have seen illustrate how precipitous this decline has become and the perilous state of our merchant marine:

As of January 1, 1980, there were 533 oceangoing vessels in the privately owned active U.S. Merchant fleet. As of July 1, 1984, that number had declined to 406.

In 1980, there were 27 commercial shipyards in our active shipbuilding mobilization base, and total average employment of production workers in those yards was 94,900.

By the end of 1983, there were only 24 shipyards because 3 were forced to close since they had no orders.

The total average employment of production workers was 84,700, or down 10,000.

Today no U.S. shipyard is building a deepwater vessel for our foreign trades.

In 1980, 72.7 percent of our liner trades moved on foreign bottoms. In 1983, however, foreign-flags increased their shares to 75.5 percent.

With respect to our total international trade—liner, dry, and liquid bulk—foreign flags carried 96.3 percent in 1980, and 94.2 percent in 1983. Although it appears we have increased our total share of cargo, the figures are misleading because the absolute tonnage carried has gone down.

At the time when all other nations engaged in maritime trade are heavily subsidizing their shipping and shipbuilding through various protectionist devices, it seems we are doing just the opposite. CDS is gone; ODS is on the way out; and our cargo preference laws appear to be more honored in the breach than in the observance.

As the committee begins its consideration of the administration's request for MarAd appropriations authority for fiscal year 1986, I believe we should pay special attention to the administrative changes which MarAd is proposing in the ODS program; and ensure that those changes do not indirectly amend the laws which Congress has enacted for the promotion of the U.S. maritime industry. Because, if substantive changes are in order, the appropriate way to make them is through duly enacted amendments to the law. That process, of course, includes thorough debate and analysis in Congress.

The consequences of circumventing the legislative process are, I believe, painfully evident from our experience with the administration's determination several years ago to terminate the statutory CDS program by simply refusing to request funds for it. Ever since, the maritime industry has been paralyzed by internal disagreements over the build foreign issue, and Congress has been forced to seek ad hoc solutions, which at best have been Band-Aid remedies for a major national problem.

I believe we should also closely examine the legislative change which MarAd will propose to the title XI program. Serious reservations have been expressed that MarAd's proposal to increase fees will effectively kill any new title XI applications. If this is the case, such a proposal would indirectly but nevertheless effectively terminate a statutory program.

Similarly, questions have been raised about MarAd's administrative authority to reduce ODS when tonnage includes military and premium-rated preference cargoes.

While such an action would manifestly result in budget savings, it may also contradict the intent of Congress when it enacted the cargo preference laws and the ODS program.

Finally I believe we should understand fully the implications of the proposal to eliminate the requirement for subsidized operators to obtain prior MarAd approval before entering nonsubsidized operations. If the result of this increased flexibility would be to affect adversely the subsidized operations of other U.S. flags, then the proposal may be at odds with the very purposes of the Merchant Marine Act.

I do not mean to prejudge any of these proposals, but I do wish to express my concern that we procced cautiously and with a full understanding of what we are being requested to authorize.

I also have a statement from Senator Hollings which he would like to have included in the record.

[The statement and bills follow:]

Opening Statement by Senator Hollings

The task before the committe today is especially difficult because we must consider how to assist our rapidly deteriorating fourth arm of defense against the background of a budget crisis which will not permit increased expenditures however worthwhile they might be.

Nevertheless, I believe fiscal responsibility also makes a positive demand upon us. Congress must safisfy itself that every program it authorizes is conceived and operated as efficiently and effectively as possible.

It is very tempting to endorse proposals which purport to cut funding below 1985 levels, but before doing so, I believe we should look very closely at any projected savings and the cost of achieving them. This is especially true here, where the maritime industry, which is such an important contributor to our national security and economic welfare, is fighting for its survival.

The present time may justify a freeze on funding, but they do not justify a lack of initiative or a bankrupt maritime policy.

It is from this perspective that I look forward to the testimony which the committee will receive today on proposals to authorize funding for our programs to promote the U.S. merchanct marine.

99TH CONGRESS
1ST SESSION

S. 102

To authorize appropriations for the maritime construction differential subsidy for fiscal year 1986, to promote a strong United States merchant marine, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 3, 1985

Mr. INOUYE (for himself and Mr. LONG) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

---

A BILL

To authorize appropriations for the maritime construction differential subsidy for fiscal year 1986, to promote a strong United States merchant marine, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That there is authorized to be appropriated without fiscal year limitation as the appropriation Act may provide for the use of the Department of Transportation, for the fiscal year 1986 not to exceed $300,000,000 for acquisition, construction, or reconstruction of vessels and construction-differential subsidy and cost of national defense features incident to the construction, reconstruction, or reconditioning of ships.

SEC. 2. Section 502(b) of the Merchant Marine Act, 1936 (46 App. U.S.C. 1152(b)) is amended by striking "50 per centum" and inserting in lieu thereof "60 per centum".

SEC. 3. Section 1103(f) of the Merchant Marine Act, 1936 (46 App. U.S.C. 1273(f)), is amended by striking "$12,000,000,000" and inserting in lieu thereof "$15,000,000,000".

99TH CONGRESS
1ST SESSION

S. 679

To authorize the appropriation of funds for certain maritime programs for fiscal year 1986.

IN THE SENATE OF THE UNITED STATES

MARCH 18 (legislative day, FEBRUARY 18), 1985

Mr. STEVENS (for himself and Mr. INOUYE) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

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A BILL

To authorize the appropriation of funds for certain maritime programs for fiscal year 1986.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Maritime Appropriation Authorization Act for Fiscal Year 1986".

SEC. 2. Funds are authorized to be appropriated without fiscal year limitation as the appropriation Act may provide for the use of the Department of Transportation for fiscal year 1986 as follows:

(1) for payment of obligations incurred for operating-differential subsidy, not to exceed $335,084,000;

(2) for expenses necessary for research and development activities, not to exceed $9,900,000; and

(3) for expenses necessary for operations and training activities, not to exceed $71,967,000, including not to exceed—

(A) $34,847,000 for maritime education and training expenses, including not to exceed $19,633,000 for maritime training at the Merchant Marine Academy at Kings Point, New York, $10,915,000 for financial assistance to State maritime academies, $3,000,000 for fuel oil assistance to State maritime academy training vessels, and $1,299,000 for expenses necessary for additional training;

(B) $9,277,000 for national security support capabilities, including not to exceed $7,932,000 for reserve fleet expenses, and $1,345,000 for emergency planning/operations; and

(C) $27,843,000 for other operations and training expenses.

SEC. 3. Funds are authorized to be appropriated for the use of the Federal Maritime Commission, in the amount of $11,940,000 for fiscal year 1986.

Senator STEVEN. Our first witness is the Maritime Administrator, Adm. Harold E. Shear. Admiral, we are delighted to see again.

STATEMENT OF HON. HAROLD E. SHEAR, ADMINISTRATOR, MARITIME ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY RUSSELL STRYKER, MARITIME ADMINISTRATION

Mr. SHEAR. Thank you, Mr. Chairman.

Senator STEVENS. Good morning, Admiral.

Mr. SHEAR. I am accompanied this morning by Mr. Russell Stryker of my staff. I would like to read an abbreviated statement, if I may, and submit a more detailed statement for the record.

I appreciate the opportunity to appear before you this morning to comment on S. 102, and to present the Maritime Administration's request for appropriations authority for fiscal year 1986.

Before I address these two subjects, I would like to briefly review the current status of the maritime industry as it has evolved under the administration's program, and to mention the promotional legislation that we plan to initiate this year.

In contrast with the steady decline in competitiveness and the related steady increase in dependence on subsidies which had for many years characterized the U.S. maritime industry, we are now entering a new era of vigorous, aggressive competition for cargo on world markets. A combination of factors has contributed to this turnaround.

An important first step was the congressional provision in 1981 for the foreign acquisition of ships by subsidized operators. Although for practical purposes the foreign built authority lasted only 1 year, authority for 34 new ships and 14 conversions was granted and, as a result, U.S. operators are now taking delivery on some of the best and most competitive diesel-powered new liner ships in the world at a third of U.S. prices and no cost to the U.S. taxpayer. We are also taking delivery on some excellent bulk ships which have also been procured.

It is true that the number of ships under the U.S. flag is declining. Much of this decline, however, is traceable to the disposal of overaged relics which we have actively encouraged. Some 90 privately owned ships of all types have been scrapped in the past 3 years.

Furthermore, despite this decline in numbers, our liner fleet has not lost delivery capacity because the new ships are much larger and more efficient than their predecessors. With modern, competitive ships, a number of our operators are aggressively seeking to increase the U.S. share of our foreign trade cargoes and the levels of the operating subsidy budget is declining.

As you know, more than 70 percent of our liner cargoes are being carried in foreign bottoms today. We intend to change this. Equally important is the new spirit of realism that is being exhibited by the seafaring unions with our strong endorsement and encouragement. Union leadership has indeed been impressive. Wage and fringe costs which had gotten out of hand with a cushion of subsidy are being significantly reduced and the unions are consistently agreeing to the much smaller crew complements of the new ships in recognition of the present economic realities.

Unfortunately, few, if any, new merchant ships will be built for the foreign trade in U.S. shipyards in the foreseeable future, given their 3-to-1 cost disadvantage. However, although the industry is undergoing some compression, there is a continuing solid base of shipyard business. Navy work is at an all-time high, and there is a modest amount of Jones Act work.

In addition, the sizable expansion of the Navy-Maritime Administration Ready Reserve Force is providing considerable new work and Navy, as well as commercial conversion and repair work, will continue.

Few of the world's shipbuilding nations today offer this level of business opportunity in a period of shipbuilding recession. In short, Mr. Chairman, the administration's maritime program is working. It is also consistent with the President's budget objectives.

In the area of promotional legislation, the administration will again pursue legislation which will authorize ship operators to build or acquire vessels overseas without loss of eligibility for operating differential subsidies. This is essential if we are to continue the progress I have outlined.

The administration will also pursue legislation which will give immediate eligibility to foreign-built vessels brought under the U.S. flag to carry cargoes for the U.S. Government.

I would like to address S. 102, which would authorize $300 million in fiscal year 1986 for acquisition, construction, or reconstruction of vessels, as you have already mentioned. It would also increase the allowable CDS rate from 50 to 60 percent, and raise the title XI commitment ceiling from $12 billion to $15 billion.

The administration is opposed to this bill. A CDS appropriation would add inevitably to the national debt and would not be justified. An increase in the maximum rate from 50 percent to 60 percent would bring the rate closer to the current actual difference between United States and foreign prices for commercial vessels. However, this subsidy is not justified when excellent vessels can be obtained abroad by U.S. operators with no addition to the national debt, and with delivery times much shorter than those which can be offered domestically.

As to the proposed increase in the title XI ceiling to $15 billion, we consider it unnecessary. At the current level of title XI activity, the level of outstanding commitments is declining rather than increasing, and that decline will continue for some time before the trend is reversed.

I would like to turn briefly to our budget request starting with certain related program proposals. First, the elimination of double subsidy.

The administration proposes to proportionately reduce subsidies when tonnages include military and premium-rated preference cargoes which are not available to foreign competition. The 1986 ODS budget request has been reduced by $20 million in light of this initiative.

Second, increased fees for the Federal ship financing guarantees, the title XI program. As a part of a multiagency initiative, the administration proposes to initiate, as you noted, a 5-percent up-front fee on new loans guaranteed, as well as a 1-percent annual loan guarantee fee.

The increase in fee revenues, which is estimated to be $13 million, will not affect appropriations but will be credited to the Federal Ship Financing Fund.

Our 1986 request for the budget is for the authorization of a total of $368.7 million. This comprises $299.5 million for operating differential subsidies; $9.9 million for research and development; and $59.3 for operations and training.

In the interests of time, I will not cover the details of these elements but will submit them for the record.

This completes my statement, Mr. Chairman. I will be pleased to answer any questions which you or the members may have.

Senator **STEVENS**. Admiral will not that 5-percent fee put the cost of financing title XI above the commercial rate?

Mr. **SHEAR**. Yes, it will, sir.

Senator **STEVENS**. Well, then, how would title XI be viable?

Mr. **SHEAR**. For the companies which do not have the best credit ratings, it may be acceptable. The stronger companies, they will probably be able to do better in the commercial market.

Senator **STEVENS**. Well, by definition, if they do not have a good credit rating, how can they afford to pay higher than the commercial rate?

Mr. **SHEAR**. It is quite possible that the utilization of title XI is going to decrease with this extra fee.

Senator **STEVENS**. Are you proposing that for the fishing vessel loans that are administered by NOAA, too?

Mr. **SHEAR**. No; it does not apply to the fishing vessels under NOAA.

Senator **GORTON**. Excuse me, Mr. Chairman.

Senator **STEVENS**. Yes.

Senator **GORTON**. Of course if no one uses it, then it will not produce the income that you indicated, either, will it?

Mr. **SHEAR**. It will not, sir.

Senator **STEVENS**. We have already cut the Merchant Marine Academy by two 10-percent cuts in enrollment, and the administration is suggesting another 5-percent cut this year. What is going to be the total effect now on the Academy of a 25-percent reduction in a 2½-year period?

Mr. **SHEAR**. We deliberately made over a 2-year period a 10-percent cut and another 10-percent cut. The Grace Commission recommended that an additional 10-percent cut be made, which we resisted. An additional 5-percent cut was decided upon for a total of 25 percent. I would not like to see that increased any more in the years ahead. What we have at present is a viable Academy with that cut, with a reasonable-sized student body and with a faculty which has full accreditation. I would not, however, like to see that cut increased.

Senator **STEVENS**. Your proposal for eliminating the double subsidy is going to require legislation, is it not?

Mr. **SHEAR**. That is under review within the administration now as to whether it could be done administratively or will require legislation.

Senator STEVENS. You are proposing a new limit on title XI commitments, as I understand it. Could you explain that to us more fully? What is it, $900 million, of which $300 million is committed only to national security activity?

Mr. SHEAR. That is correct, sir. That question at present is somewhat academic, because we do not foresee approaching that limit of $900 million in the immediate future. The projection for 1986 is for $300 million, and there is considerable doubt as to whether that will be reached.

Now with regard to going from $600 million to $900 million, that is for national security interests, and the commitments will be resolved or addressed on an individual basis should we go beyond $600 million.

Senator STEVENS. I am going to yield to Senator Inouye.

Do you have questions?

Senator INOUYE. Mr. Chairman, I have several questions here. Some are rather complicated and complex. If I may, I would like to submit them for the record.

The first question relates to MarAd's proposal to give blanket authorization to subsidized operators who engage in unsubsidzed operations. I believe it will require some study on MarAd's part to respond to the questions adequately.

The other relates to cargo preference laws which again I believe are rather specific in nature and would require some thought on MarAd's part. I do have a few, however, that I am certain you can respond to this morning.

Admiral, your testimony this morning seems to be encouraging the foreign acquisition of ships by subsidized operators and the continued payment of subsidies for these vessels. It is my understanding, having met with the CEO's of seven principal American-flag liner operators, that they have been trying to formulate a proposal which would establish a level playing field for liner operators. I am certain you are aware of this.

I am also certain you are also aware that this cannot be achieved with the build-foreign program that you are now encouraging.

Therefore, my question is: Is not MarAd's proposal a divisive influence at a time when operators are trying to get together?

Mr. SHEAR. I am very pleased to see that the operators have been addressing some long-term problems. I am encouraged that they are having these extensive discussions.

With regard to the importance of building foreign, if I understand your question correctly, Senator Inouye, that is very important if we are going to continue to rebuild and rejuvenate this fleet so that it can be competitive in the world markets.

What we have been able to accomplish in the past several years with the new ships which we are now taking delivery on in increased numbers is most impressive. We are now in a position where we can start to take over from the foreign bottoms a much larger percentage of the cargoes than we have had at any time in the recent past. We must obtain this authority if we are going to be able to expand our fleet and modernize it and improve it in the years ahead. It centers around the cargoes which we are able to obtain.

Senator **Inouye**. You do not think that your action is divisive of this effort on the part of the liner operators?

Mr. **Shear**. It is certainly not intended that way.

Senator **Inouye**. The build-foreign program, as I am certain you are aware, would divide them.

Mr. **Shear**. It is certainly not intended that way. We must get these new ships if we are going to continue to have a viable merchant marine at all in the years ahead. There is no way to get those competitive ships in American yards at the present time.

Senator **Inouye**. Both ODS and cargo preference are statutory programs created by the Merchant Marine Act intended to promote the merchant marine fleet. Admiral, is there any specific provision in that act which directs MarAd to reduce an operators ODS when the tonnage he is carrying includes military and premium-rated preference cargoes which are not available to foreign competition? If not, specifically where is the statutory authority for MarAd to do this administratively as it proposes to do?

Mr. **Shear**. There is no language in the law itself that specifically states that, sir.

Senator **Inouye**. You have no statutory authority to do this administratively?

Mr. **Shear**. That is being reviewed within the administration at the present time, as to whether we must get legislation, or whether we can do it administratively.

Senator **Inouye**. So at this moment you are not certain whether you do have the authority to do it administratively?

Mr. **Shear**. That is correct, sir.

Senator **Inouye**. Will your agency keep this committee informed as to the progress you are making on that research?

Mr. **Shear**. I will do so, sir.

Senator **Inouye**. The committee has received information that the Department of Transportation and/or MarAd are drafting a legislative proposal to deregulate our domestic offshore trade. Is that information correct?

Mr. **Shear**. That information is correct. It is being drafted—it is being reviewed within the administration at the present time.

Senator **Inouye**. Are you going to submit this?

Mr. **Shear**. I believe it will be submitted. It is still being reviewed. I believe it will be submitted in due course, sir.

Senator **Inouye**. How do you propose to deregulate our domestic offshore trade?

Mr. **Shear**. That has not been determined in detail. It has been reviewed and studied. I could not give you an accurate answer on it this morning, sir.

Senator **Inouye**. If you do not know how to do it, why do you want to do it?

Mr. **Shear**. When we come forward, we will have a solid proposal. It would be inappropriate for me to attempt to give you an answer on something that we are now studying and reviewing at the present time, sir.

Senator **Inouye**. I would assume that if you are taking on an objective of this sort, you must have concluded that there is justification or necessity for such deregulation. What is the justification or necessity?

Mr. SHEAR. One of the justifications is the desire for increased competition.

Senator INOUYE: At the expense of whom?

Mr. SHEAR. Increased competition in the offshore areas.

Senator INOUYE. Well, I will be looking forward to receiving your suggestions, sir. I find it rather strange that you are for it, but you do not know what to do with it.

This morning the committee will hear testimony from others that the title XI program is about to be hit this spring and summer by a wave of claims that could easily overwhelm its supporting assets. In that event, title XI defaults will have to be paid by the taxpayers.

What is the amount of the assets in the title XI revolving fund? Is that fund endangered by potential defaults?

Mr. SHEAR. In the title XI revolving fund, which is what I believe you are referring to, sir, there is approximately $160 million at present.

Senator INOUYE. And do you think that it is being endangered by potential defaults?

Mr. SHEAR. That is a very good question, and I would like to review, if I may, what has been transpiring here in the past several years.

With this tremendous worldwide recession and depression in all aspects of shipping, we have had to pay off in defaulted loans in the past 2 years—2 years plus—well over $200 million. In addition to that, we have been stymied in bankruptcy cases by court proceedings where we have not been able to take over vessels totaling some $130 million in defaults, so that we have not been able to utilize those vessels for sales.

Of the vessels which we have taken over we have sold some $80 to $90 million worth. We would like very much to have the opportunity to sell the current vessels which are tied up in court proceedings so that we can replenish and increase the revolving fund. It all goes into the revolving fund.

We have at present several sizeable possibilities of default coming up ahead. The industry overall is still in deep depression. I do not know whether the revolving fund is going to be able to take care of everything or not. So far, we have done quite well in keeping the revolving fund solvent.

If the worst-case situation should develop such that we would have to make more payoffs on bonds at the demand of the bondholders, the law provides that we can borrow temporarily from the Treasury and then pay it back again as the revolving fund increases. I hope we do not have to do that.

Senator INOUYE. Mr. Chairman, I have a few other questions, but I think I have taken enough time.

Senator STEVENS. We will submit them for reply by the Admiral.

Senator STEVENS. Senator Gorton.

Senator GORTON. No questions.

Senator STEVENS. We thank you very much, Admiral.

Mr. SHEAR. Thank you, Mr. Chairman.

Senator STEVENS. We will be in touch with you as we mark up the bill.

[The statement follows:]

Statement of Hon. H.E. Shear, Maritime Administrator, on Behalf of the Maritime Administration, Department of Transportation

Mr. Chairman and Members of the Committee: I appreciate the opportunity to appear before you this morning to comment on S. 102 and to present the Maritime Administration request for appropriations authority for fiscal year 1986. Before I address these two subjects, I want to briefly review the current status of the maritime industry as it has evolved under the Administration's program and to mention the promotional legislation that we plan to initiate this year.

In contrast with the steady decline in competitiveness and the related steady increase in dependence on subsidies which had for many years characterized the U.S. maritime industry, we are now entering a new era of vigorous, aggressive competition for cargo in world markets. A combination of factors has contributed to this turnaround.

An important first step was the Congress' provision in 1981 for the foreign acquisition of ships by subsidized operators.

Although for practical purposes the foreign build authority lasted only a year, authority for 34 new ships and 14 conversions was granted. As a result, U.S. operators are now taking delivery of some of the best and most competitive diesel-powered new liner ships in the world—at a third of U.S. prices—and at no cost to the taxpayers. Excellent bulkers are also being acquired.

It is true that the number of ships under the U.S.-flag is declining. Much of the decline, however, is traceable to the disposal of overaged relics, which we have actively encouraged. Some 90 privately-owned ships of all types have been scrapped in the past few years. Furthermore, despite the decline in numbers, our liner fleet has not lost delivery capacity because the new ships are much larger and more efficient than their predecessors.

With modern, competitive ships a number of our operators are aggressively seeking to increase the U.S. share of our foreign trade cargoes and the level of the operating subsidy budget is declining.

Equally important is the new spirit of realism that is being exhibited by the seafaring unions, with our strong encouragement.

Wage and fringe costs, which had gotten out of hand with the cushion of subsidy, are being significantly reduced, and the unions are consistently agreeing to the much smaller crew complements of the new ships in recognition of the present economic realities.

Few, if any, new merchant ships will be built for the foreign trade in U.S. shipyards in the foreseeable future, given their three-to-one cost disadvantage. However, although the industry is undergoing some compression, there is a continuing, solid base of shipyard business. Navy work is at an all-time high and there is a modest amount of Jones Act work. In addition, the sizeable expansion of the Navy/MarAd Ready Reserve Force is providing considerable new work and Navy as well as commercial conversion and repair work will continue. Few of the world's shipbuilding nations offer this level of business opportunity in a period of shipbuilding recession.

In short, Mr. Chairman, the Administration's maritime program is working. It is also consistent with the President's budget objectives.

In the area of promotional legislation, the Administration:

Will again pursue legislation that will authorize ship operators to build or acquire vessels overseas without loss of eligibility for operating-differential subsidies (ODS). This is essential if we are to continue the progress I have outlined.

Will also pursue legislation that will give immedaite eligility to foreign-built vessels brought under U.S.-flag to carry cargoes for the U.S. Government.

I would like to turn now to S. 102, which would authorize $300 million in fiscal year 1986 for acquisition, construction, or reconstruction of vessels, and construction differential subsidy (CDS), plus national defense features. It would also increase the allowable CDS rate from 50 percent to 60 percent and raise the Title XI commitment ceiling from $12 billion to $15 billion.

The Administration is opposed to this bill. A CDS appropriation would add inevitably to the national debt and would not be justified. An increase in the maximum rate from 50 percent to 60 percent would bring the rate closer to the current actual difference between U.S. and foreign prices for commercial vessels. However, this subsidy cost is not justified when excellent vessels can be obtained abroad by U.S. operators with no addition to the national debt and with delivery times much shorter than those which can be offered domestically. That is why we are proposing the renewal of the build-foreign authority for subsidized operators.

As to the proposed increase in the Title XI ceiling to $15 billion, we consider it unnecessary. At the current level of Title XI activity, the level of outstanding commitments is declining rather than increasing. We estimate that by the end of fiscal year 1986 it will have gone down to $6,673,000,000 from $7,303,000,000 at the end of fiscal year 1984, and that there will be a further decline before any increase in program activity reverses the trend. It is clear that there is no need for a ceiling increase at this time. That concludes my comments on S. 102.

At this point I would like to turn to our budget request, starting with certain related program proposals and then addressing the budget details.

Elimination of "double subsidy." The Administration proposes to proportionately reduce subsidies when tonnage includes military and premium rated preference cargoes which are not available to foreign competition. The 1986 ODS budget request has been reduced by $20 million in light of this initiative.

Increased fees for Federal Ship Financing (Title XI) Guarantees. As part of a multi-agency initiative, the Administration proposes to initiate a five percent upfront fee on new loans guaranteed and also on advances as well as a one percent annual loan guarantee fee. The increase in fee revenues, which is estimated to be $13 million, will not affect appropriations, but will be creditd to the Federal Ship Financing Fund.

Our 1986 request is for the authorization of a total of $368,712,000. This comprises $299,500,000 for Operating-differential Subsidies, $9,900,000 for Research and Development, and $59,312,000 for Operations and Training. Some of the details behind these elements of our request follow:

OPERATING-DIFFERENTIAL SUBSIDIES

The Administration continues to meet its obligations under existing operating-differential subsidy contracts. The 1986 approporiation request totals $299,500,000—$29,700,000 less than the current estimate for 1985. Three proposed ODS reforms are expected to take effect: (1) a change in the method of determining foreign competition for subsidy rate calculations will reduce subsidies by an estimated $4,000,000; (2) elimination of the requirement for subsidized operators to get prior MarAd approval before entering non-subsidized operations will stimulate diversions to such operations and thus further reduce subsidies by an estimated $11,584,000; and (3) in accordance with a recommendation of the Grace Commission, the Administration will seek to eliminate the "double subsidy" resulting from the payment of ODS while a vessel carries military and premium rated civilian preference cargoes. ODS is designed to cover the difference between certain U.S. and foreign ship operating costs and thus to offset the competitive disadvantage of the American operators. However, the cargo in question is not carried at conference rates and is not subject to foreign competition. These three reductions will offset $35,584,000 of the estimated $335,084,000 cost of subsidizing operations of 108 ships during 1986.

RESEARCH AND DEVELOPMENT

The requested Research and Development program is frozen at the 1985 funding level. This provides $2,965,000 to achieve greater shipbuilding productivity and to develop new and improved shipbuilding machinery; $2,525,000 to improve the efficiency, competitiveness, and safety of U.S.-flag operations; $2,860,000 for the Computer-Aided Operations Research Facility at Kings Point, New York; and $1,550,000 for Advanced Maritime Technology.

OPERATIONS AND TRAINING

Our authorization request for Operations and Training for 1986 is $59,312,000. This level combined with sums being carried forward from previous appropriations for a school ship replacement, would result in an Operations and Training program level for 1986 of $67,812,000.

The overall reduction of $9,655,000 from the 1985 appropriation of $77,467,000 reflects the non-repetition of a one-time 1985 cost of $5,000,000 for refurbishment of the Santa Mercedes and the exclusion in 1986 of State training ship fuel costs, which were funded at $2,000,000 in 1985. Further savings are derived from a five percent Government-wide reduction in salary scales (−$1,155,000); certain administrative savings (−$1,900,000); compliance with the Deficit Reduction Act (−$888,000); and other management reductions (−$507,000).

The above savings are partially offset by 1986 costs of the 1985 pay raise ($1,200,000) and other unavoidable cost increases ($940,000).

Finally, the Operations and Training request for 1986 reflects a five percent decrease in the number of freshmen entering the U.S. Merchant Marine Academy (−$60,000). Such reductions were recommended by the Grace Commission, and reflect the fact that there is an over-supply of officers. Also, included is a reduction in the estimate for student incentive payments at the State maritime schools (−$285,000).

Overall, the State academies have fared well during this period of Federal budget constraint. we are continuing schoolship maintenance at the $8,000,000 level. Student incentive payments are proposed at a level consonant with expected demand without imposing reductions in quotas. The deferral of schoolship replacement funds is proposed simply because replacement is not necessary at this time.

Thank you very much, Mr. Chairman.

[The following information was subsequently received for the record:]

Questions of Senator Inouye and the Answers

Question. (a) Will MarAd be totally relinquishing its authority to regulate nonsubsidized service by subsidized operators? For example, Farrell Lines is presently required under its ODS contract to make 44 sailings per year on a route between the U.S. Atlantic Coast and the Mediterranean with three vessels. Wouldn't MarAd's proposal permit a large subsidized company to provide nonsubsidized service on the same trade route even though a small company like Farrell could not possibly compete? In other words, what control would you have over a large subsidized operator taking advantage of another subsidized operator by using nonsubsidized sailings where a small subsidized company cannot hope to compete?

(b) Along these same lines, isn't it inconsistent for the Government to support a liner through ODS and then threaten its stability by placing it in an environment in which it can't compete? In that event, won't this proposal create a competitive situation which will threaten the Government's multi-billion investment in ODS?

Answer. Under present regulations subsidized operators attempting to compete with foreign-flag operators must file applications for MarAd approval before they can expand their operations into nonsubsidized services. MarAd currently has under review various alternatives to these regulations which could allow greater nonsubsidized services, including total relinquishment of its authority to regulate nonsubsidized service by subsidized operators. MarAd has not yet decided on any particular alternative and therefore cannot respond at this time to any particular alternative. It is noted generally that be foregoing subsidy to operate in a nonsubsidized trade, the subsidized operator is at an operating cost disadvantage vis-a-vis other operators—subsidized and foreign-flag—on that route. In view of the low level of penetration by U.S.-flag liner operators in the U.S. direct trades, whatever alternative is chosen will be designed to encourage greater trade participation.

Question. Has MarAd ascertained whether it has the resources to ensure that subsidized operators do not underwrite their nonsubsidized sailings with the ODS they receive?

Take the example of a subsidized operator with nonsubsidized services and a nonsubsidized operator with nonsubsidized services which are competing on the same trade route. Wouldn't the subsidized operator have an advantage when the subsidy it receives gives it a cost advantage on its nonsubsidized services, even if the subsidy comes from another route?

In that connection, in the executive summary of MarAd's September 1984 study on the reevaluation of U.S. liner trade routes, it is stated that U.S. subsidized operators already on a route "would retain an advantage (subsidy) over newcomers" providing nonsubsidized services. By the same token, wouldn't a nonsubsidized operator already on the trade route be at a disadvantage with respect to a subsidized operator with nonsubsidized service? In short, I don't understand how you can prevent subsidy from being used to underwrite nonsubsidized service.

Answer. As I mentioned, MarAd is currently considering various proposals to allow greater nonsubsidized services, including the total relinquishment of this authority to regulate nonsubsidized service by subsidized operators. It has not yet selected any particular proposal, and therefore cannot comment on any particular alternative. Further, as you know, the subsidy system is designed for the recovery of that portion of certain operating expenses for which an operating company is at a competitive disadvantage with respect to its principal foreign competition. The system provides for certain operating differential payments in a specific area, and is not intended to provide a capital base for other operations.

Question. Another matter that perplexes me is the interrelationship of your three proposals to reform the ODS program. One proposal MarAd makes is to eliminate double subsidy. Against let me take one of the three smaller companies and, for purposes of discussion only, I will again use Farrell. MarAd proposes to allow a subsidized operator to provide nonsubsidized services on Farrell's route and at the same time MarAd will eliminate the double subsidy by not paying ODS for the carriage of certain preference cargoes. If such cargoes account for a substantial amount of the revenue on Farrell's route, couldn't this combination of regulatory changes irreparably harm Farrell who must still offer the 44 voyages? Couldn't the same be said of Prudential and Waterman? How can MarAd prevent this from happening?

Answer. In concert with the Administration's directives, the Maritime Administration is trying to remove impediments to flexible operations by subsidized operators.

All subsidized operators, not just Farrell, Waterman, and Prudential, will be affected by the proposed elimination of double subsidy if they do not adjust their overall operations to compensate for the reduced subsidy attributable to preference cargoes.

The combination of these initiatives could harm individual operators if they did not adapt to this less regulated marketplace and continued to rely on the preference cargoes as the mainstay of their operations. Should this occur, the subsidized operator would not possess a competitive advantage over others. The role of subsidy is to provide for the recovery of that portion of certain operating expenses for which an operating company is at a competitive disadvantage with respect to its principal foreign competition—not to guarantee profits.

Senator **STEVENS**. We will now hear from Vice Chairman Carey of the Federal Maritime Commission.

Good morning, Mr. Chairman. Would you identify the people who are with you for the record.

STATEMENT OF JAMES J. CAREY, VICE CHAIRMAN, FEDERAL MARITIME COMMISSION, ACCOMPANIED BY RUSTY JOHNSTON, COUNSEL TO THE CHAIRMAN; ROBERT D. BOURGOIN, GENERAL COUNSEL; AND FREDERICK F. TRUTKOFF, DIRECTOR, OFFICE OF BUDGET AND FINANCIAL MANAGEMENT

Mr. **CAREY**. Yes, Mr. Chairman. With me today are Mr. Rusty Johnston, the chairman's personal counsel; Mr. Robert Bourgoin, the Commission's general counsel; and Fred Trutkoff who is our Director of the Office of Budget and Financial Management.

Mr. Chairman and members of the subcommittee, I am pleased to appear before you today representing Chairman Green, who is out of town, for the purpose of presenting for your review and consideration the fiscal year 1986 budget estimates for the Federal Maritime Commission.

Our fiscal year 1986 budget estimate in the amount of $11.6 million provides funding for 212 total workyears of employment. This estimate is a reduction of $686,000 and 27 work-years below the $12.3 million and 239 work-years budgeted for fiscal year 1985. This reduction is comprised of $586,000 less for personal services and $100,000 less for administrative expenses.

Mr. Chairman, while this is a significant reduction from our current authorized levels, our actual personnel levels are approximately 225. I make mention of this for several reasons.

First, we are making significant progress toward obtaining this goal not by waiting until fiscal year 1986 to achieve it, but by starting now in this fiscal year. Thus with the proper planning, this 212 workyear allocation is obtainable without RIF's which, as you know, are not only demoralizing and disruptive but initially are very costly.

Second, by making these reductions now we are able to absorb the $290,000 for pay increases that went into effect 2 months ago.

Accordingly, we have advised OMB that a supplemental appropriation will not be necessary.

Then third, we found in light of the passage by the Congress of the Shipping Act of 1984 and the decreased Federal role which it portends, that the Commission personnel strength of 212 people is, in my opinion and the opinion of Chairman Green, the correct personnel level.

I would like to comment on a few specifics in the budget. First you will note that we have proposed reduced personnel levels in fiscal year 1986 in the Bureau of Tariffs. These reductions are due to several factors. One, the fact that domestic tariff filings have dropped off significantly resulting in a 6 man-year reduction.

Second, we anticipate that further savings will accrue once service contracts are placed on automated equipment, and that is a project that is currently underway. Also, we project a 2 work-year reduction if the legislative proposal to transfer the passenger vessel certification program is successful, and we look forward to working with you and the committee to accomplish an orderly transfer of this function to the Department of Transportation.

You will note that we are requesting funding for the tariff automation project in the amount of $180,000. Now that much of the work associated with the initial implementation of the new Shipping Act has been completed, the Commission is moving forward with its tariff automation project which envisions a paperless electronic system for the filing, storage, and retrieval of tariff information.

In October of 1984 Chairman Green announced that a task force had been formed, which I head up, to explore the feasibility of an automated tariff filing and information system to replace our present manual system. This task force will review the possibility of developing a pilot automated tariff filing system.

Some of the things we have done to date: At the present time, detailed tariff automation questionnaires have been sent to various members of the shipping community to elicit information from them regarding the need for tariff automation and the type of information needed from any future system.

Tariffs that are currently in hard copy format are very difficult to handle and extremely expensive to use and manipulate, and fall far short in my opinion of their potential of furthering competition and contributing to the international ocean commerce. This system would be developed to service the needs of the Commission as well as satisfy the information needs of public tariff users in the conduct of American's foreign ocean commerce.

Extensive coordination of the project will be accomplished through surveys, the establishment of an advisory committee, public hearings, and the feasibility study for which the funding is requested. While the success of our efforts is by no means certain, our ultimate goal is to have the tariffs filed outside the agency at a private sector location and to operate at no cost to the Government. A key ingredient in the success of this effort will be to plan for a private sector operation which provides accurate and clear information at a reasonable fee. While we are probably some 3 years from this goal, I feel it important that you know of our efforts and that we continue to seek this increased efficiency objective.

Two other points are worth mentioning. We will complete the procurement of word processing and personal computer equipment during this fiscal year, which results in approximately $300,000 savings in our fiscal year 1986 budget.

I mention this because we are able to satisfy all of our computer requirements using personal computers as opposed to a large mainframe computer which the Commission had previously leased. The annual cost, including personnel, of the mainframe computer—the lease of which was terminated in fiscal year 1983—exceeded the total one-time cost of our personal computer procurement.

I am not going to sit here and suggest that we have solved all the problems either with the Shipping Act or trade related or managerial, but I do think we are making substantial progress. I would also readily admit that regulatory implementation of the Shipping Act in the 6 months' timeframe that was allotted to us did in fact put a bit of a strain on the Commission, but I think by and large the comments that I have both read and received, that the industry, both carriers and shippers, are pleased.

On another subject, the 5-year study which the Shipping Act mandates is proving to be initially internally quite time consuming. While we are convinced the study is necessary, we are looking for ways to keep the costs down and wherever possible limit data requests to the maritime industry to the minimum possible. In this regard, I think the automated tariff filing system may well prove to have a significant positive impact on the data needs for that 18(a) study.

Finally, from a program standpoint, we are planning initiatives in a number of areas. Shortly, the Commission will be publishing a proposed rule which will either exempt from filing or Commission review a broad sector of port and marine terminal agreements. This rulemaking which arose out of the Commission's port inquiry will eliminate to a large extent the regulatory burdens placed on this sector of the maritime industry. The Commission is also currently in the analysis phase and will likely issue rulemakings in the near future which would eliminate some of the uncertainty which may currently exist in the area of service contracts and NVOCC coloading arrangements.

In summary, let me once again indicate that the budget we present to you today for your consideration is not only in my opinion realistic and adequate to do the job, but reflects a real effort on our part to hold the spending line in every area possible within the FMC.

I would again thank you for the opportunity to appear here today to outline our plans for your review and consideration, and I would be pleased now, in company with the Chairman's staff, to answer any questions the committee may have.

Senator **Stevens**. Senator Inouye asked Admiral Shear about the proposal for deregulation of the offshore trades which are mentioned in the FMC's budget document. Are you involved in that preparation?

Mr. **Carey**. Senator, we have not been to date. I am sure ultimately we would be, but there has been no structuring of any proposed legislation that has come forward from the Commission.

We did send a letter to Chairman Packwood back in January 1983 in which we suggested that Congress may want to consider taking a look at the domestic offshore situation. In particular, the thing that we tend to target in on, and I know Chairman Green addressed this at the House hearings, is the jurisdictional responsibility between the ICC and the FMC, and that area in particular we think needs attention, in that the domestic offshore rate tariffs right now can be filed with either agency. As a result, you tend to have segments of the industry in fact shopping, for lack of a better term, for the best deal. I do not think that is in the best interest of a properly controlled regulatory scheme.

I would also reiterate, as the Chairman has said, that we do not view this as a turf battle between us and the ICC. We just think it is something that needs a logical solution as to which agency the tariff should be filed with, and we would in fact—if and when this goes forward—we are more than ready to work with the ICC and the Congress to try to help fashion a solution.

I would also stress that we would certainly go forward with nothing on our part without close consultation with the committee and the Congress.

Senator STEVENS. Section 13(b)(5) of Shipping Act provides the means to protect U.S. carriers from discrimination in foreign trade. How aggressively do you think the FMC should use that new provision? Have you started any consideration of it yet?

Mr. CAREY. We in fact have. I hesitate to speak fully for all of my fellow Commissioners, but I think we are ready in fact to pursue it quite aggressively. We take very seriously our role in the statutes as the protector of the U.S.-flag carriers freedom to compete in foreign crosstrades.

We in fact have issued the rules that spell out the procedures for complaints under 13(b)(5) and for Commission action, and in structuring those rules there was considerable discussion amongst the Full Commission that in fact we meant to send a signal to the industry worldwide that we were serious about 13(b)(5). I would also indicate that this resulted in considerable foreign-flag comment on the proposed rule.

Another effort that has gone forth, in January of this year Chairman Green sent a letter to U.S.-flag chief executive officers seeking to establish communication channels specifically on the subject of 13(b)(5), and setting up meetings with them, one, to review their current cross-trade activities, the countries that are involved, the magnitude of their trade in any of these given crosstrades, and, second any problems that they have had in the past as a result of Government interference or problems they have had in the past with commercial practices to prohibit their entry into the crosstrades.

And then finally we have been asking them of any plans that they have for any new or increased cross-trade activity. All of this we are doing, quite frankly, to establish our own library of information so that when the first 13(b)(5) situation arises, we in fact are ready to proceed. And Chairman Green, I believe, has met with three of the CEO's thus far, and the others are being scheduled.

From that, I would assure you the Commission, I feel, is ready to move forward aggressively when the circumstances arise.

Senator STEVENS. That is good. Will you be able to handle planned personnel reductions through attrition? Do you believe this budget is adequate to fund your activities for fiscal year 1986?

Mr. CAREY. Yes, sir, I do. As a matter of fact, as I indicated in my statement, we have already, simply through attrition, proceeded toward that goal. One of the things that has assisted is part of this dichotomy between filing the domestic tariffs with the ICC or the FMC. As that tariff filing has moved over to the ICC, it quite frankly has reduced the number of domestic tariffs filed. And that is, although we are not talking about big numbers, we feel that has reduced the need for some six people in the Bureau of Tariffs.

Senator STEVENS. Thank you very much.

Senator Inouye.

Senator INOUYE. Because of a loophole in the law, cargo bound for or originating in the United States cannot be transported without filing a tariff with the FMC. I am referring to the Cast situation. Last year I introduced legislation to remedy this problem, and this year I have done the same thing. What is the FMC's position on this? Last year I believe the agency was for it.

Mr. CAREY. To a degree I am going to have to wing this one, Senator, but in my personal opinion, not speaking for the rest of the Commission, it is my understanding that in the Cast situation, at least on the east coast, that cargo diversion flows northward to a considerable extent, and on the west coast the cargo in fact gets diverted from Canada to the United States, and that overall it is a balance.

I can fully understand that that is very little help to those on the east coast. The Commission—you are correct. The Commission last year I believe testified that we were in fact for it, and it would be something that if the Congress were to pass it there would be no real additional problem for us to handle that increase in tariff filings.

Senator INOUYE. What is the Commission's policy in administering the Controlled Carrier Act?

Mr. CAREY. Well, we quite frankly, if a given operation falls within the parameters of that act, we have required them to register. There have been, to the best of my recollection, a number of cases in the last 2 years where carriers from developing nations have questioned whether they in fact fall under the controlled carrier provisions.

We have found, as I recall, that they do if their ownership is more than 50-percent government controlled. So we have followed, in my opinion, the letters of the law there quite strictly.

Senator INOUYE. You do not believe in leaning over backwards to assist these so-called controlled carriers?

Mr. CAREY. I would say not, no, sir. At least in the discussions that have ensued amongst the five Commissioners, no, it has been pretty much what are the provisions of the law, and in fact if they fall within those parameters they are a controlled carrier.

Senator INOUYE. In response to the chairman's first inquiry on deregulation, you indicated that the FMC has not been called upon to provide any advice or in no way were you consulted. Has the Commission adopted a policy on deregulation of domestic offshore trades?

Mr. **Carey**. No, sir; I would say no, other than the current statute which is on the books. We continue to enforce it. And in fact, as indicated in particular in your home State, the matter that came up in the last few months where the Commission decided—and it was not a unanimous vote, but in fact a split Commission—the Commission decided to go forward out of the interests of the consumers' side of the people of Hawaii on a particular rate increase in that trade. The general discussion around that subject was that in those trades there is a tendency toward one carrier having a great deal of control over it, and the people of Hawaii under that statute are given the protection of the Commission to at least ensure that it is being done fairly, and that is the reason we moved forward on that.

So I guess in answer to your question, no, we do not have a policy other than the statute.

[The following information was subsequently received for the record:]

Federal Maritime Commission,
Washington, DC, April 1, 1985.

Mr. Lloyd Beasley,
Printing Clerk, Committee on Commerce, Science and Transportation, Dirksen Office Building, Washington, DC.

Dear Mr. Beasley: Subsequent to the Commission's authorization hearing on March 21, 1985, I obtained additional information relative to the first part of Senator Inouye's question on page 34 of the galleys. If you would insert the following language, surrounded by brackets, it would be appreciated. I suggest bracketing the language to make it clear that it was not part of my original testimony.

[On that part of your question, have we been called upon to provide any advice or been consulted, the FMC staff met recently with OMB, DOT and MARAD staff members to review various options. We have been advised that the FMC will be given the opportunity to review a draft proposal if and when it is cleared by OMB and DOT for release.]

Thank you for your assistance in this matter.

Sincerely,

James J. Carey, *Vice Chairman.*

Senator **Inouye**. Mr. Chairman, I have a few other questions I would like to submit for the record.

Senator **Stevens**. We would appreciate it if you would respond to Senator Inouye's questions.

Senator **Stevens**. Senator Gorton?

Senator **Gorton**. Thank you. Mr. Carey, can you enlighten me on the current status of the complaint by certain timber and other shippers in the Northwest against the recent rate increases of the Trans-Pacific Westbound Rate Agreement Conference?

Mr. **Carey**. Yes, sir; first of all, I would say that the rate increases that were filed in that particular instance of the TWRA Conference were viewed very seriously by the entire Commission. It was not a split vote. It was a unanimous vote when we moved forward. There were over 60 shipper complaints from a wide variety of industries anywhere from woodpulp, to meat products, to wastepaper.

The major complaint of the shippers was that the rate increase was, very bluntly put, too much too soon, and particularly the medium- and small-sized operations were being seriously hurt. They just could not absorb the 50- and 100- and 150-percent rate increases in a period of 2 months.

Based on that, the Commission last week unanimously decided to move forward with a section 15 order. It is basically a series of very detailed questions on the operations of that conference to gather more information on what had actually gone on in these particular deliberations to increase these rates so that we could determine what further action would be appropriate under the law. I believe the comments—we gave them 21 days—those comments are due, I think, April 3.

Second, the Chairman testified at Senator Packwood's hearing in Oregon on March 15, concerning some possible future courses of action that the Commission might take. One of the things he addressed was the possibility of seeking injunctive relief under section 6(h) of the 1984 act on the grounds of an unreasonable cost increases.

Other areas that he outlined that we might follow, depending on the information that is gained from the questions that were sent, is the possibility to investigate and/or seek to enjoin under section 11(h) on the grounds of violation of the prohibitive acts section of the 1984 act; possibly dealing with operating under an unfiled agreement; possibly dealing with operating not in accordance with the agreement filed with us; the possibility of a group boycott occurring; and the violation of the independent action provisions.

All these are possibilities, but we do not really have the information at this point to move forward. I would hope we would get that with the filing of those answers. I would stress that from our viewpoint at least the discussions on this have not broken down. We have a continuing and ongoing dialog with both the carriers and the shippers in this case.

We are hopeful for a commercial resolution to it. I do not know, on a scale of 1 to 10, I would hesitate to say what the possibilities of that are. We have received some indications that independent action may already be being taken in some instances, and perhaps that might solve the problem in and of itself.

Senator GORTON. As you know, I regard this as a very important test of the effectiveness and the appropriateness of the 1984 act on which we worked so long. So I may tell you that I appreciate your efforts in this regard, and the seriousness with which you have taken this complaint. I would encourage you to continue to treat it seriously.

Maybe one last question. Can you give me any estimate as to when you think you will have enough information in order to make the determination as to what action is appropriate?

Mr. CAREY. The responses are due on April 3. I would think very shortly thereafter, once some initial analysis is done, we would schedule a Commission meeting and make a determination at that point. It could be as soon as probably 2 weeks after that, simply because, as I indicated, the questions that we sent were quite detailed and really delve into the interactions of what went on inside that conference to determine the minimums that were discussed, and the rate increases that were discussed.

It will take some time to analyze them.

Senator GORTON. But you do still have some hope that there could be a commercial solution that would be reasonably acceptable to most parties, at least?

Mr. **Carey**. We have that hope. I think time will tell. There is more information that keeps coming in on it, frankly, every day from the shippers, and they are the source we are using, to say there may be some breaks in this thing and it may resolve itself. But if it does not, I will assure you that under the 1984 act we understood what the Congress wanted there, and we consider this a test also, and as I said, in the deliberations I saw a very determined Commission in all five Commissioners. It was a unanimous vote, and we will not shirk from our duty on this.

Senator **Gorton**. Thank you.

Thank you, Mr. Chairman.

Senator **Stevens**. Senator Trible.

Senator **Trible**. Thank you, Mr. Chairman. I have no questions, but I do want to welcome Vice Chairman Carey and his colleagues today, and thank him for his testimony.

Senator **Stevens**. Thank you very much, gentlemen. Does anyone have any questions for the other gentlemen accompanying Mr. Carey?

Senator Rockefeller.

Senator **Rockefeller**. No questions.

Senator **Stevens**. Thank you very much.

Mr. **Carey**. Thank you, Senator.

[The following information was subsequently received for the record:]

Federal Maritime Commission,
Washington, DC, May 1, 1985.

Hon. Daniel K. Inouye,
U.S. Senate, Washington, DC.

Dear Senator Inouye: This is in response to questions for the record you forwarded to the FMC following my testimony at the recent FMC authorization hearings. The questions relate to testimony given by Commissioner Philbin during his confirmation hearing. In his testimony, Commissioner Philbin advised that the ability of carriers in our domestic offshore trades to select for themselves whether they will come within FMC or ICC jurisdiction "renders further administrative actions in the area of deregulation of questionable efficacy." He stated that further inquiry is necessary to:

> Determine the level of regulation that is needed to balance the barriers to entry in these trades resulting from Jones Act restrictions;
>
> Determine whether the ICC or the FMC is better suited to undertake this regulatory responsibility.

You ask whether this is the position of the Commission. Moreover, you request a more detailed explanation of the problems and how they relate tot he Hawaii trade.

The answer to your first question is that the testimony by Commissioner Philbin referred to above does reflect the position of the Commission. Your second question raises the bifurcation of regulatory responsibility issue and requires a brief review of the respective jurisdictions of the ICC and the FMC.

It has been said that the FMC regulates only port-to-port rates while the ICC regulates intermodal rates. This, however, is an oversimplification. The question of jurisdiction turns not on the existence of an intermodal movement but rather on whether the carriers providing the transportation hold themselves out to the public as joint participants in a through route. A rate jointly established by an ocean carrier in the domestic offshore trades and an ICC-regulated rail or motor carrier for the through movement of cargo from a point of origin on the route of one carrier to a destination point on the other must be filed with the ICC, *PRMSA* v. *ICC*, 645 F.2d 1102 (D.C. Cir. 1981), *TMT* v. *FMC*, 602 F.2d 379 (D.C. Cir. 1979). Such rate must be filed with the ICC even in those cases in which the inland portion of the movement takes place entirely within the port city, or the port area for that matter, and the ocean portion covers thousands of miles. *Alaska Steamship Co.* v. *FMC*, 399 F.2d 623 (9th Cir. 1968).

Not all intermodal rates involve a joint holding out by the ocean carrier and the inland carrier. For example, an ocean carrier may contract with a motor carrier to provide pickup and delivery services without naming that carrier as a joint participant in its tariff. Such an ocean carrier holds itself out to the public in its own name to provide ocean transportation and pickup and delivery. Rates covering such transportation must be filed with the FMC. Matson Navigation Company—Container Freight Tariffs, 7 F.M.C. 480 (1963). *IML Sea Transit Ltd.* v. *U.S.*, 343 F.Supp. 32 (D.C. Cal. 1972).

Often there is little or no practical operational difference between the ICC-regulated service and that regulated by the FMC. The choice of the regulatory agency depends upon whether the ocean carrier enters into a joint through arrangement with the inland carrier or treats the inland carrier as a subcontractor. This makes "forum shopping" an easy matter.

"Forum shopping" is not simply a theoretical possibility, but a regular occurrence. Shortly after the FMC concluded its rate investigation in the Puerto Rican trade,[1] the carriers restructured their tariffs to reflect joint through intermodal arrangements. This effectively deprived the FMC of jurisdiction in that trade. The major carriers in the Alaska trade took similar action a number of years ago. *Alaska Steamship Co.* v. *FMC*, 399 F.2d 623 (9th Cir. 1968). The smaller carriers in the trade that continue to file tariffs with the FMC have been exempted from the Commission's financial reporting requirements pursuant to 46 C.F.R. § 512.2(e). With the larger carriers filing tariffs with the ICC and the smaller carriers exempt from financial reporting, there has, as a result, been no active review of the rate-of-return of carriers operating in the Alaska trade for a number of years.

The Hawaii trade presents a somewhat different picture. Matson Navigation Co., the major carrier serving Hawaii, unlike the carriers serving Puerto Rico and Alaska, continues to file most of its tariffs with the FMC. See Joint Rail-Water Rates to Hawaii, Matson Navigation Company, 351 I.C.C. 213 (1975). It could, however, restructure these tariffs to bring itself under ICC jurisdiction at any time it chooses.

Carriers in the American Samoa (where there is foreign-flag competition) and Guam trades continue to file tariffs with the FMC. However, the trades are small and there have been no rate cases since 1977.

Because most carriers in the domestic offshore trades are subject to ICC jurisdiction, modification of the Intercoastal Shipping Act, 1933 to eliminate rate-of-return regulation, would have little or no practical effect, except in the Hawaii trade. The effect of such deregulation on the Hawaii trade is difficult to assess. Although Matson's share of the Hawaii trade has declined somewhat in recent years, its share remains approximately seventy percent. It is unclear whether there would be sufficient competition in the Hawaii trade to keep rate levels at reasonable levels in the absence of regulation, especially given the Jones Act restrictions on entry to the domestic offshore trades.

Given the limited impact which any modification to the Intercoastal Shipping Act, 1933 would have in most domestic offshore trades and the uncertainties regarding the effects of competition in the Hawaii trade, the Commission has not made an evaluation of alternative approaches to deregulation. However, regardless of the modifications which may be made to existing FMC regulatory requirements, it would be desirable to bring the bifurcated jurisdiction in the domestic offshore trades to an end. Although the Commission believes that a single agency should have exclusive jurisdiction over the domestic offshore trades, as stated in Chairman Green's letter of January 21, 1983 to the Chairman, Committee on Commerce, Science, and Transportation, the Commission takes no position over which agency should have that jurisdiction.

Sincerely yours,

JAMES J. CAREY, *Vice Chairman.*

Senator STEVENS. The next witness is Jesse Calhoon, president of the National Marine Engineers' Beneficial Association.

Good morning.

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[1] Sea-Land Service, Inc., Trailer Marine Transport Corporation, Gulf Caribbean Marine Lines, Inc., and Puerto Rico Maritime Shipping Authority, Proposed General Rate Increases in the Puerto Rico and Virgin Islands Trades, Docket No. 81-10 (F.M.C., September 25, 1981), 20 S.R.R. 1627.

STATEMENT OF JESSE M. CALHOON, PRESIDENT, NATIONAL MARINE ENGINEERS BENEFICIAL ASSOCIATION

Mr. CALHOON. Good morning, Mr. Chairman, members.

Mr. Chairman, I have a prepared statement that we have submitted, and I know your able staff has gone over it because I have gotten several questions on it. So if it is permissible with you, I would just insert the statement in the record and touch on a few of the more important points.

Senator STEVENS. Yes, sir; we will print it in the record, and you are right that we have gone over it.

Mr. CALHOON. The first point I would like to point out, Mr. Chairman, is that the administration in its appearance before the House committee raised an issue that had been settled years ago in the Federal courts. That was the issue of operating differential subsidy for operators carrying preference cargo.

We thought this had been settled several years ago in the Federal courts, and we are unalterably opposed to any change in the current structure. If this is done, it will put at least one major berthliner out of business, and the situation is more critical now than it ever was.

Because of deregulation in the railroads, there has been a redirection of the flow of cargo from the Mississippi River Valley to the east coast and west coast, and this has left the operators in the gulf area very short of cargo. There is very, very little container cargo moving from the gulf now, and this has come about simply by the deregulation of the railroads.

These operators are surviving basically on these Government cargoes, and they would be put to the wall if this is changed.

I will just touch on users' fees, Mr. Chairman. The ports serve the Nation, and they have since the inception of this Nation. To throw users' fees over onto the shipping companies would just get us in a multitude of battles internationally. The deeper the port, the bigger the ship, the more efficient the ship, the cheaper it becomes to move the cargoes, and the consumers are the people who really get all the advantages of the deeper and bigger ports.

Mr. Chairman, I have raised one issue on Merchant Marine Academies. What is happening in those academies is very sad. They are fine schools, and they are turning out fine young men, and when they graduate they come to the union halls looking for employment. When we tell them there is no employment, they look at us like we have stolen Lindberg's baby. There are a lot of things they could do in other industries, and I think they should be redirected into areas where there are some job opportunities when they finish.

There are absolutely no job opportunities in the merchant marine. Our union has not even handed out an application form in 4 years. We have unemployment, and to have five fine State academies and a fine Federal Academy to turn out these wonderful students, and to have no chance in employment in what they are trained for is very, very sad.

Mr. Chairman, since the first year of the Reagan administration when there was a 1-year window open that allowed the American steamship companies to build foreign, no new ships for the international trade have been built. Our union would much rather see those ships built in the United States, much rather; but if you had the subsidy, the CDS subsidy now, nobody could build the ships. We are just so noncost competitive—and I do not think the cost competition is a fair cost competition. I think the foreign yards are putting out bids now for ships that are less than the cost of components in the ship costs.

But that is the ship we have to compete with, and we cannot compete in any trade in the foreign commerce if we have to build American unless there is a drastic change in the subsidy system and the money appropriated to fund the subsidy system.

I am recommending to the committee that they take a look at the Armed Forces budget, Mr. Chairman. The Armed Forces are now building some fine ships for military support, but the cheapest support they can get is from the merchant marine. If we can have ships engaged in international commerce that are earning their livelihood for 20 years, out of that 20-year span the Defense Department may need the ships 1 year, 2 years, or 3 years. They only have to pay that 1/20th or 3/20th of the cost of the ships.

If they build a ship and lay it up, they are paying the total cost of the ship for the 20 years. It seems to me that we know that they can get much, much cheaper seapower to take care of their needs in case of a national conflict by building an international fleet under the American flag.

If they have the international fleet under the American flag, they also have the manpower to man that fleet in time of war. They can put ships in the boneyard. There is no boneyard for seamen. And as we know, in every other conflict this Nation has had—World War II, Vietnam, and Korea—our so-called allies refused to go into those areas of conflict.

In Vietnam, they loaded ships, the crew refused to sail them, they had to unload them and reload the cargo back onto an American ship. So if they want national security, they must have (a) the equipment; and (b) the manpower to operate it, and that cannot be achieved through an "IF" fleet.

Mr. Chairman, the competition in the coastwise and intercoastal trade is becoming a very unfair competition, in that all of our competitors can acquire equipment where and when they need it, and we are stuck with the requirement to build American.

If our competitors are going to be allowed to acquire their equipment, where they want, then some arrangement should be made for the coastwise operator to let him acquire his equipment on a competitive basis. My personal recommendation would be to set up some kind of a subsidy for the coastwise operators on a construction differential subsidy for the building of coastwise ships.

Something must be done, and what I am recommending is that the Senate engage or employ somebody to do an indepth study of our coastwise shipping and what needs to be done to preserve it and hopefully expand it.

That covers the items I wanted to bring to your attention, Mr. Chairman.

Senator STEVENS. Thank you very much.

What do you think about this proposed 5 percent title XI initiation fee?

Mr. Calhoon. Mr. Chairman, right now our competitors are building ships at a very cheap price at interest rates of about 8.5 percent. I have even heard of some recently going down to 7.5 percent interest. Under the title XI program, the rate right now would be about 12.75 percent, and to throw on an additional 5 percent surcharge on top of the 12.75 is just insanity.

Mr. Chairman, I warned this committee last year that we were heading into a serious problem with title XI, and we think the problem has come through mismanagement. We think the 5 percent surcharge is just a coverup of the mismanagement of the program. We highly recommend to this committee that they go into the title XI program and air the facts to see what has happened. We know this is a disaster on its way to happening.

Senator Stevens. I noted your comments about the defense bill. Senator Inouye and I both are on that Appropriations Subcommittee. In the past years, you know I have tried to initiate a proposal to use some funds that were at that point unobligated in the Department of Defense, and that proposal met almost universal opposition from the industry.

I think it came primarily because of the fact that no one else had thought about it, and since it was not their idea, everybody else was against it. No offense meant to my good friend Senator Inouye; I do not think he took that position. He merely conveyed to me the gripes that he was hearing throughout the industry and suggested that such an approach would meet in public the opposition we were getting in private.

How can we accomplish the objective that you articulate this morning if we cannot get the industry together on what is a proper approach as far as the Department of Defense is concerned?

Mr. Calhoon. Mr. Chairman, I do not think we can do anything unless we can get the industry together. I want to commend you and Senator Inouye on making efforts to do that. I think you will make headway in getting the industry together.

Senator Stevens. You proposed a Jones Act study in your testimony. Do you think we can get unanimous agreement, or even substantial agreement, from the industry on such a study if we were to initiate it this year?

Mr. Calhoon. I would think so, Mr. Chairman. The only reservations I have heard come from some of the coastwise, intercoastal, and nearby foreign operators, that have invested large sums of money. Obviously they are entitled to some protection of that money, but there are several ways that that protection could be built into any legislation.

Senator Stevens. I would be most pleased to initiate a comprehensive study. As you know, my State passed an initiative last year to mandate our Governor to take steps to bring about some changes in the Jones Act. I will have to cut out that paragraph of your statement, send it to Governor Sheffield, and tell him he is making progress.

I do think that it is time to review our coastwise trading laws and I would hope that we might be able to get some bipartisan support for a study. And perhaps we ought to have an industry committee designated to do that. I do not think it should be done in government. But we would be happy to meet with you and discuss further your concept.

Senator Inouye.

Senator **Inouye**. Mr. Chairman, I would like to join you in commending Mr. Calhoon for his suggestion that we have a Jones Act study. I have been long advocating this, because the alternative is what we have today. Every year, some piecemeal suggestion is made as to how the Jones Act should be amended. I think we should once and for all, and I think the time has come, look into the Jones Act and see whether it is serving its purpose, or whether we can improve upon it.

I shall be most happy and prepared to do whatever I can to assist in this.

On the matter of the Defense Department being involved in our commercial fleet, are you speaking of a build and charter program?

Mr. **Calhoon**. No, I am not.

Senator Inouye: In the construction of these ships, I am certain the Defense Department would insist that these ships would be militarily useful. Would ships that are militarily useful be also useful in our commercial trade?

Mr. **Calhoon**. Mr. Chairman, at Dunkirk a rowboat was militarily useful. So I do not know what is meant by "militarily useful." I know every ship that is built, and we are building some, so I know the cost of them, is about $3 million that a shipowner has to pay to put in the military requirements into an American ship.

So every ship that gets built under the American Flag has those militarily useful requirements built into it. That goes from the two compartment stability, which is very expensive to put in a ship, to the stronger decks that would hold the heavier military equipment, to atomic washdowns. There are about 12 items that are required to be put into every American ship.

So I think any ship—now the military had a study done about 15 years ago that said the ideal tanker for military usefulness was 25,000 tons. Well, a 25,000-ton tanker cannot make a living in any trade that I know of. But with the advancement in shipbuilding technology, they can take a 100,000-ton tanker now and give it more maneuverability than what the 25,000-ton tanker could 15 years ago. They can almost make them do a break dance now.

We had that one ship, the so-called spy ship, that could stand still in the ocean in a 12-foot wave. You can turn a ship now, a major ship, in its length, and maneuverability was the basis for the military usefulness. Well, a 100,000-ton tanker can take 50,000 tons of oil and have less draft than a 25,000-ton tanker. It would not be full, but it would be carrying twice the oil the 25,000-ton tanker would, and be drawing less water.

So I really do not know what the Navy means by "militarily useful." I know at the beginning of World War II we lost 200 ships in the first 6 months within sight of our coast. Not one of those ships today would be considered by the Navy as militarily useful. They were basically our coastwise, nearby foreign, and intercoastal fleet, but they were small ships. They were old ships. Most of them were left over from World War I, but they kept the sealanes open until we could get a shipbuilding program in place and start producing the ships.

Senator **Inouye**. Mr. Chairman, Mr. Calhoon has made an observation which I have never seen made before, an observation which I believe deserves serious consideration. In his testimony, he has pointed out, for example, that this year the Merchant Marine Academy will be graduating more merchant officers than we did 20 years ago, yet we have less than half the ships and less than half the personnel.

I think this matter deserves much study. I would hope that our staff can look into this. I, for one, would be interested to know where these graduates are ending up, if jobs are not available. And much as I would like to carry on the traditional Merchant Marine Academy, if the Academy is not serving the intended purpose, then I think we had better look into it.

Furthermore, we do involve ourselves in assisting other State-operated merchant marine academies, and there too we should make a study; because I had no idea that this was the situation.

About what percent of our graduates end up in merchant-fleet related activities? Do you have any idea?

Mr. **Calhoon**. No, I do not. The Department of Commerce did a study years ago, and at that time I believe the percentage of academy graduates that worked 5 or more years in their profession was under 10 percent of the graduates.

Senator **Inouye**. Under 10 percent?

Mr. **Calhoon**. Yes, sir.

Senator **Stevens**. Well, I would be happy to join with you in requesting the GAO—I think that would be the best thing—to do a study both of the Merchant Marine Academy and the State-operated academies to determine what is the impact of these federally financed programs.

There is a proposal as you know, Senator, for consolidation of all of the Federal academies. I think that, too, merits review now in view of the limitations on the expansion of the armed services themselves. It may well be that we ought to look at the whole subject. But I would join you on a study of the Maritime Academies.

Mr. **Calhoon**. Mr. Chairman, it is not just the shrinkage in the number of ships that has affected the academy, it is the structural change in the manning of the ships. The typical ship of 15 years ago would carry three third-assistants. The modern ship carries one. So when one ship replaces three, four, five of the old ships, there are 15 or 20 jobs disappearing and only 1 appearing. That is where the academy graduates have to get their threshold start is as a third assistant. And all the new ships will only carry one.

Senator **Stevens**. Senator Trible?

Senator **Trible**. Thank you, Mr. Chairman.

Mr. Calhoon, can you more specifically talk about your proposal that there should be greater cooperation and coordination between the Defense Department and the Merchant Marine? Obviously there ought to be a better meshing of these important programs. Do you have some thoughts that you might share with us today?

Mr. **Calhoon**. Yes; one of our major shipowners was in my office 1 week ago, and he had chartered a vessel pursuant to an RFP put out by the Defense Department. This vessel was to go into the Sealift Program over in Diego Garcia. The ship has been on charter for about 1½ years now, and I do not know whether it has ever been to Diego Garcia. But he found his ship in his own port eating his lunch.

The military was now taking his ship and taking it into his home port and loading it with a military cargo that he would have carried as berthline cargo. So it is those type of operations.

Just a few years ago there was kind of a notorious steamship operator that had old, junk vessels. He bid in the North Atlantic cargo, and the vessels on which he was proposing to carry the cargo were over 40 years of age. He underbid the regular berthliners in the North Atlantic, and the military turned the cargo over to this junk operator and destroyed the cargo base of the two major shipping companies in the European trade.

First off, the military should not be chartering a 40-year-old ship. Second, they should not be chartering a ship from an operator that had the reputation this operator had. He had one ship lost at sea and he failed to notify the Coast Guard for 9 days after the ship was sunk. There is a lot of mismanagement, or nonthinking management that is going on in the military.

Senator TRIBLE. Well, certainly there are substantial sealift requirements that remain unmet, and there ought to be ways that we can strengthen our merchant marine and, at the same time, serve our defense requirements. However, that is a very difficult task, as you very well know.

I remember as a Member of the House of Representatives serving on the Merchant Marine Subcommittee of the Merchant Marine and Fisheries Committee, and on the Seapower Subcommittee of the Armed Services Committee, encouraging my senior colleagues to get together and talk. Well, it took several years before I could even get them in the same room.

As I recall, we held one hearing, which was not particularly productive. Regrettably, my efforts were not successful in trying to establish a meaningful colloquy between those two authorizing committees, and I am struck by your suggestion that there should be another study.

I cannot quarrel with the merits of that suggestion, but it strikes me that this is the most studied of all industries in America; and that, rather than studies, what we need is an effort to achieve some kind of consensus about what needs to be done.

The frustrating thing for me, quite honestly, looking out at a room full of friends all representing distinctly different viewpoints about this industry and its future, is that the maritime industry speaks with so many voices that it is becoming increasingly irrelevant. It is becoming increasingly irrelevant to the public discussions that go on in the Congress, and obviously impotent in terms of achieving some kind of meaningful change.

The national interests so clearly, so clearly support a strong maritime presence that there must be a way that we can, those of us who care about America and recognize the national security implications of seapower, that recognize that we are an island nation heavily dependent on the world around us—and you cannot fuel this industrial giant with aircraft, but only with ships; and you cannot export our products overseas with aircraft, but only with ships; that our economic vigor and our military might absolutely demand a strong and viable maritime presence.

It does not exist. It has not existed for years. We have made absolutely no progress in the last 8 years, and we are falling further and further behind in spite of all of our best efforts.

I share with you my frustration. I simply commend to you and to your colleagues in the industry the absolute necessity that we try to achieve some kind of consensus, that we begin speaking with one voice and not hundreds of voices, and that we once again redouble our efforts to try to map out a strategy that is in America's best interests. It may not be in the best interests of each and every sector of the maritime economy, but that is in America's best interest.

You, I have always found to be a very thoughtful fellow, and I appreciate your contribution today. I look forward to working with you and your colleagues in the industry.

Mr. CALHOON. Thank you, Senator. I certainly concur in every word you said.

Senator STEVENS. Senator Rockefeller.

Senator ROCKEFELLER. I have no questions.

Senator STEVENS. Senator Inouye.

Senator INOUYE. Mr. Calhoon, I note that the Maritime Advisory Committee is going out of existence. Would you tell us why?

Mr. CALHOON. Well, I do not know the reason why, Senator. It has not served any useful purpose. In my opinion as a union president, if I want to get something done I do it. If I want to get something stalled, I set up a committee.

And I think it served the purpose of stalling.

Senator INOUYE. That is a good answer.

Thank you very much, Mr. Chairman.

Senator STEVENS. Thank you very much, Jesse. It is nice to see you.

Mr. CALHOON. Thank you.

Senator STEVENS. I am going to talk to you about that Jones Act study, too.

[The statement follows:]

STATEMENT OF JESSE M. CALHOON, PRESIDENT, NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION

Mr. Chairman, I welcome this opportunity to testify today on behalf of the National Marine Engineers' Beneficial Association on the FY '86 Maritime Administration budget request and on S. 102 which would authorize funds for continued construction differential subsidies.

Let me begin with the budget. We are deeply concerned by this year's budget request—but we are by no means surprised. This budget is essentially the same budget we have been seeing for the past four years—no construction subsidies, minimal operating subsidies, and promises of foreign building, with an occasional joker thrown in like user fees.

The result of these past four years is clear in the numbers. In early 1981, we had some 570 vessels in our commercial fleet; today there are 517. And reputable forecasts indicate that this number could be reduced to between 300 and 350 by 1990 if present trends continue.

I am realistic enough to know that in today's national budget and tax situation, proposals for new programs that involve higher expenditures, or for tax incentives that cost revenue, are going to remain proposals and nothing more. But this budget offers no promise for the future, only four more years of decline. And such decline is unacceptable in view of the maritime threat we face today.

This budget reflects a bankrupt national budget and bankrupt maritime leadership. I note with some scorn how far we have come from the promises of 1980 for a revitalized maritime industry. We all remember those promises well; there is no need to repeat them today. Systematically, existing maritime promotional programs have been dismantled and little put in their place. Operating subsidies would be gone as well if they had not been locked in by contract—and despite this the Maritime Administration has attempted at times to pervert their stated purpose from a program to make U.S. ships competitive into a gigantic windfall for some operators.

Now this year there is mention of other changes to the operating subsidy program, such as eliminating ODS for operators carrying cargo preference cargoes—a proposal which would doom one or more of our few existing liner companies. And there are more changes to the subsidy program being discussed by MarAd, which its Administrator has described to Members of this Committee as an "administrative" matter but which I believe Members of this Committee ought to examine with careful scrutiny.

Now this year we also see user fees rear their head again. This proposal has not gotten off the ground since 1981, and it ought to remain there. What other nation in the world charges user fees of 40 to 65 percent as is now proposed? Government maintenance of ports and waterways is not some Great Society program of the 1960's. Our government has been improving waterways and harbors for two hundred years, because they're good for trade and good for commerce. These improvements are not special interest; they're national interest. I find the idea of user fees similar to proposing in 1941 that Hawaiians pay the cost of World War II simply because they were the ones attacked.

Instead of user fees, we ought to see a coherent, innovative maritime program designed to increase our fleet, not deplete it.

Instead of wasting scarce maritime dollars on increased funding for Merchant Marine and state maritime academy graduates—few of whom will have seagoing jobs when they graduate—we ought to radically scale back this training program as long as the fleet continues to decline as it is today. Mr. Chairman, twenty years ago, our fleet was nearly double in size with an even greater number of jobs, yet today MarAd plans to graduate more Merchant Marine Academy graduates (230 vs. 219) than there were in 1965! I wish to make clear that I am not complaining of the academies as such. They are fine institutions, and they turn out fine graduates. But their purpose should be redirected to other areas of our industry that could use their educational input. It makes no sense to train the same numbers of mariners for seagoing jobs when, for example, changes in crew composition offer about 25 percent of the employment that existed for academy graduates.

Instead of continuing to fund a bloated MarAd staff where there are still more people watching the fleet than there are ships in the fleet, we ought to cut the staff in half to start and apply the money toward the subsidy program that keeps ships sailing. Just ten more ships operating would be worth more to our security than several hundred bureaucrats.

And instead of proposals to increase the user cost of Title XI, the Administration and the Congress ought to take a close, hard look at the way this program is being administered by MarAd—a point I have made repeatedly to this and other committees.

Mr. Chairman, I want to emphasize this point. I respectfully suggest that we are well on our way to disaster in the Title XI program, and this Committee should take an immediate, hard look at the way it is being administered. I use the word immediate because the Title XI program is about to be hit—this spring and summer—by a bow wave of claims that could easily overwhelm its supporting assets. The bills will have to be paid on Title XI defaults, and if this means paying new, unplanned millions out of an already strained Federal budget then the prospect of business-as-usual while Title XI founders cannot be attractive to either the Congress or the Administration. I believe that if you scratch this Title XI fee increase proposal, you will find underneath a massive cover-up of gross mismanagement. Furthermore, rather than facing this problem openly, the facts are being treated as if they were classified or proprietary corporate information, when really what is at stake here is not a TOP SECRET weapons system but mismanagement of the taxpayers' money.

But Mr. Chairman, as I said before, I am realistic. We are not going to see any new maritime spending programs this year. I think, however, that we have an obligation to follow any new direction to stop the maritime decline that will continue remorselessly if four more budgets such as this one are the only program we have.

With this in mind, I want to mention three additional proposals for this Committee's consideration. First, I want to reiterate my support for build foreign, but I also want to reiterate a point I made last year before this Committee. If operators are permitted to build or acquire abroad and if they are then permitted immediate eligibility to carry cargo preference cargoes, then the vessels benefiting from this eligibility must be the most modern, efficient possible. Indeed, I would recommend that they be no older than a year old. This would help keep preference cargo rates as low as possible—a consideration that is incumbent upon our industry at a time when many are questioning the entire concept of cargo preference. It would demonstrate, for example, that our industry can work with farmers to our mutual benefit. This is not just wishful thinking, Mr. Chairman. As I have noted to this Committee in the past, a study by the First Boston Corporation showed that with modern, efficient ships built abroad for P.L 480 shipments and used on long-term charters one could reduce U.S.-flag rates 50 percent below what they are today. Indeed, two modern U.S.-flag bulk ships, the AURORA and the ARCHON—built abroad and receiving no operating subsidy—have been able to bid rates within just a few dollars of the world average.

Second, I believe that this Committee, working with the Senate Armed Services Committee, should seek to redirect a portion of the Defense budget toward support of an operating U.S. commercial fleet. This would, I hope, be a primary consideration of the Commission on Merchant Marine and Defense which was authorized by law last year. I recommend this, because the reason, after all, that we have a Navy is to ensure that our commercial fleet and sealift ships can do their job. If there is no sealift to protect, then not only are we in a lot of trouble but we also have no need for a Navy. Furthermore, the missions that drive the size of the rest of our forces largely are related to forward defense—and defense forward of our shores means transport to get those forces there and keep them supplied.

Now the Navy will tell you that they are spending more on sealift then ever before. They are. They will show you nice photos of TAKRX and TAKX—and these are nice ships. They will show you their program to rebuild our reserve fleet—and it's a good and long-overdue program. But taken as a whole, the Navy's sealift program is a drop in the bucket compared to our potential needs. Taken together, TAKRX and TAKX total little more than twenty ships—and they will cost billions before they're done. Taken together, the Navy's seaflift program is fine for a small war in which the Soviet Navy plays no part. It bears no relation to our real needs if the more than 350 Soviet submarines should be ordered to contest the seas. In fact, by putting our eggs in a few baskets—so to speak—it does not relieve our vulnerabilities, it accentuates them.

To deal with a broad-based threat, we need a broad-based response. And we need a fleet in-being—not a James River fleet that fifteen years from now no one will know how to operate.

When I speak of re-directing a portion of the defense budget, I believe that I speak with justification. More than one defense official has estimated that in any major conflict 95 percent of our logistics would have to be carried by sea. Yet, the Department of Defense budget for airlift and sealift routinely has allocated more than 90 percent for airlift. Small changes in the Defense Department budget would mean major changes in our sealift posture—and there are few observers around who do not believe that changes in our sealift have to be made.

My third proposal for your consideration concerns the Jones Act. I would urge the Committee to initiate a comprehensive study of the Jones Act to include recommendations for changes. This Act, along with the Merchant Marine Act of 1936, is the backbone of our industry. But it also could be revised or updated in order to make our industry grow, not just protect a piece of our turf. For example, the Act currently mandates that Jones Act vessels be built in the United States. This provision, enacted to help shipbuilders, means that Jones Act operators must compete with trucks and railroads which can purchase their operating equipment wherever they want. We now pay for operating equipment three times as expensive as it needs to be—and that is no way to be competitive. With foreign-built vessels, I know our ships could haul a container of cargo far more cheaply from Boston to Miami, or from San Francisco to Anchorage. Rates would go down; consumers would benefit; and the U.S.-flag fleet would increase—substantially. To be certain, there would have to be compensation of some sort for those operators, such as Matson Lines, who invested under today's rules. But a comprehensive study would include such considerations, and a comprehensive study would place other proposals, such as that to re-flag passenger ships, in an industry-wide not a special-interest context.

Finally, Mr. Chairman, I would like to comment briefly on S. 102, Senator Inouye's bill to authorize $300 million for CDS. I support this proposal but with one important condition. It must involve full parity—parity on time of construction, on the cost of money, on operating costs if these costs are clearly related to U.S. construction, and parity on construction and operating costs generated by any required military features. The shipowners and operators just cannot afford to subsidize shipyards or the Navy—the margin of survival these days is too thin for that—and parity considerations involve many, often submerged costs that are not counted in the mere price differential in vessel building costs. If fair parity can be provided, then I am happy to support this bill, and I commend the Senator from Hawaii for its introduction.

Mr. Chairman, I will conclude my remarks at this point. I would be happy to answer any questions you might have.

Thank you, Mr. Chairman.

[The following information was subsequently received for the record:]

National Marine Engineers' Beneficial Association,
Washington, DC, April 10, 1985.

Hon. Ted Stevens,
Chairman, Subcommittee on Merchant Marine,
U.S. Senate, Washington, DC.

Dear Senator Stevens: During my appearance before your Subcommittee on March 22nd concerning the FY 1986 MarAd authorizations, you asked me about build-and-charter and Senator Trible asked about Navy/merchant marine cooperation. Because I believe that both these issues are extremely important, I would like to amplify my responses, and, with your permission, I would hope that my additions could be included in the hearing record. I am taking the liberty of sending copies of this letter to Senator Trible and Senator Inouye.

Thank you for your consideration of this.

Sincerely yours,

J.M. Calhoon, *President.*

1. Amplification of response to Senator Stevens regarding build-and-charter

I fully agree with the basic thrust of your proposal to use funds from the Department of Defense budget to fund civilian resources that have a direct military application—such as commercial sealift. I certainly had no quarrel with the proposal for a build-and-charter program. However, what troubled me about the proposal, as it was then drawn, was the fact that the ships would have been built in U.S. shipyards. This, I believe, would have made the program completely cost-ineffective, producing perhaps five vessels when conceivably twenty might have been built abroad for the same $500 million in the proposal. If the proposal provided for new, efficient, foreign-built ships, I would be first in line to offer my support, for I think that the basic idea itself has much merit. Without the build abroad proviso, we would merely have a few more high-cost ships which, as I explain in my response to Senator Trible in detail below, is the wrong way to go in view of the massive Soviet submarine threat.

2. Amplification of response to Senator Trible regarding merchant marine and DOD cooperation

The object of my remarks on closer cooperation between the merchant marine and the Department of Defense is to increase the military impact of our merchant marine—as a provider of sealift and as a force multiplier for the Navy. I believe that this task is vital for our national defense in the coming years, and the security benefits would far outweigh the relatively small budgetary impact on DOD. It will, however, require a change in current thinking, but a change that is essential if we are to meet the many challenges we face.

Simply put, we must develop new and imaginative ways to improve our nation's military capabilities by planning to use civilian assets in wartime roles from day one in any future conflict. What can be done with sealift assets is a good example of this. We face too many diverse threats around the globe and we face such growing budgetary pressure that there is no way that we can provide the necessary capabilities simply with standing military forces.

In sealift, the requirements and the possibilities are clear and compelling.

Just forty-three years ago this spring, the merchant ship on which I sailed was torpedoed off the Gulf Coast. We could see shore lights in the distance as we took to the lifeboats. That sinking was only one of more than two hundred off our coasts in those early months of 1942.

With the Pacific Fleet hammered at Pearl Harbor and the Atlantic Fleet bottled up in some ports by fear of further losses, our Navy left the merchant marine on its own. The merchant ships themselves—with virtually no self-defense capability—were sitting ducks in their own home waters. Our Allies—those that were left to us—were swamped with problems of their own.

More than two hundred ships were sunk by fewer than twenty German submarines—submarines that were primitive by today's standards.

Today, we are acting as if we have learned nothing from the events of World War II. We think that the Navy will have time to take care of the merchant fleet during a war while dealing with a far more powerful naval threat—surface and subsurface. We conduct official studies on sealift requirements that seem to ignore the real effect of wartime losses. We plan for Allied reinforcements and reinforcements from other nations—when both sources may be paralyzed by practical and political constraints of their own. Yet the truth is that the threat and the problems we face now could, in a future war, make 1942 seem like a picnic by comparison.

First, we lack numbers of merchant ships. With our fleet reduced to some seven hundred government and commercial ships, there is simply no way that we could fulfill our sealift requirements and meet our basic economic import needs at the same time in a major war. Many of the ships in our reserve fleet are World War II Victory Ships. And lack of numbers means that battle losses cannot be replaced, for no one believes that a future conflict will provide the opportunity we had in World War II to build a merchant fleet from scratch.

Second, the Soviet Union has a fleet of more than three hundred submarines. Our losses—from even a fraction of these submarines—could be staggering. The Soviet Union, by contrast, has a fleet of approximately 2,500 merchant ships—and many of these operate in a close support role with their navy.

Third, with this threat in mind, we are actually handicapped by the enormous increase today in individual merchant ship carrying capacity. This phenomenon works for us economically in peacetime. But, in war, a single enemy torpedo could deprive us of five to twenty times the cargo carrying capability that an enemy torpedo could in World War II.

Fourth, many or our merchant ships are ill-suited to our potential military requirements. Very large crude carriers and large non-self-sustaining container ships are not quickly adaptable to military needs. Self-sufficient break-bulk cargo ships are slowly disappearing from our fleet—a problem the Soviets have been careful to avoid. The Navy and the Maritime Administration are just beginning to address this problem with new programs such as crane ships to unload containers and "Sea Shed" sets which enable container ships to carry outsized military cargo. But these programs are late and nowhere near on a scale equal to the need.

Fifth, our oceangoing merchant marine work force is declining. Today, there are less than 20,000 shipboard jobs. The work force is also aging. If war broke out tomorrow, we would have difficulty manning our reserve fleet and vessels that might come to our flag from flag-of-convenience nations. Ten years from now, the task could well be impossible. This is one reason why the nation needs an economically-active merchant fleet in-being.

Sixth, we place far too much reliance on flag-of-convenience fleets and the fleets of our NATO Allies. The so-called U.S. effective control fleet is mostly large tankers and large dry-bulk carriers, not general cargo ships. There is also no real guarantee that these ships would join our flag in time of war, because under International Law it is the flag of registry and not the flag of ownership that controls a vessel.

Furthermore, as I said before, we would have great difficulty finding crews to man these vessels. NATO ships will only be available if the war involves a direct attack on NATO nations, and even these fleets are rapidly shifting to flag-of-convenience nations. The British fleet, for example, has shrunk from more than 10 million deadweight tons to about 20 million—in just eight years. Many German and Norwegian ships have also been transferred to other flags.

There are, of course, vast numbers of merchant ships in the world, although much of the tonnage is in jumbo tankers. But many of these ships are essential to the basic livelihood of other nations and thus cannot be diverted to our uses. And our Navy is going to have its hands full just keeping key sea lanes open and dealing with the Soviet Navy—whose power is well appreciated. When war breaks out, we and our Navy, even with our Allies, are simply not going to have the time to conduct the necessary diplomacy or the resources to go around the world collecting merchant ships to serve our needs while dealing simultaneously with what will necessarily be our first priority—destruction or neutralization of the Soviet Navy.

As you can see, this is a depressing and formidable list of problems. They are not the only difficulties we face in the area of sealift, but they provide an idea of what we are up against.

We cannot solve these problems overnight, but it is time we addressed them seriously and with imagination.

I believe that we must begin with a comprehensive national maritime program, led by the President and the Congress, to rebuild, modernize, and increase our merchant fleet. Increased numbers of ships must be a key objective in this program. Many have proposed a series of measures to this end—measures to increase available cargo, greater regulatory reform, tax measures, measures to attract capital.

But we also must undertake measures to increase the military impact of our merchant fleet. Despite a few modest programs in this direction, such as Sea Shed which I mentioned earlier, the Navy is going in precisely the opposite direction.

The Navy is emphasizing sealift assets under its control—such as the SL-7 or TAKRX fast sealift ships and maritime prepositioning ships, or TAKX. These will be magnificent ships, superb for doing a limited job--primarily oriented toward the Persian Gulf contingency. But they would be a drop in the bucket compared to our actual needs if a war broke out. And they total only twenty vessels—all very high value, all highly-lucrative targets for Soviet torpedoes and cruise missiles.

They may be nice to have, but they really are gold-plated sealift carried to its ultimate conclusion. These two programs alone will cost billions of dollars. Just five TAKX ships being built at General Dynamics are estimated to cost many billions over their lifetime. This same money could keep afloat a commercial fleet many times that number, and, as I emphasized earlier, numbers are important. We simply cannot risk our future security by putting all of our eggs in one basket.

So my first recommendation would be to take as much money as possible from these or other DOD programs and put it into broad-based support for our merchant fleet.

My second recommendation concerns measures to increase the military utility of our merchant ships. For a relatively small DOD investment, existing and future container ships could be designed for quick installation of on-board cranes and Sea Shed sets so they can carry and discharge military cargo on their own. At a minimum, such equipment should be stockpiled in ports for quick installation.

I should make clear at this point what I mean by military utility. Above all, I do not mean that we should have gold-plated merchant ships that look, act, and cost like Navy warships. We need numbers of ships; we need functioning hulls. After all, at Dunquerque, anything that floated, even the small private sailboat, was military useful. Certain features can be build into vessels; other add-ons can be stockpiled. But in no way should we depart from the principal objective of "more ships." When the time comes, we will be happy to have anything that floats and no one will care whether a particular vessel met some bureaucratic peacetime definition of what is militarily useful ten years before.

I should note that the Navy, in addition to sponsoring some limited preparation along these lines, is now talking of funding defense enhancements on new ships built in U.S. yards and funding the operating cost of these enhancements to the operator (i.e., increased fuel costs for added weight) for the life of the vessel. This is a highly-encouraging development, although its potential will be fatally crippled until such a program includes foreign-built vessels since almost no new commercial vessels are being built in U.S. yards and this extra assistance will in no way make U.S.-built ships commercially viable in the international trades.

My third recommendation would be to institute a series of programs designed to enable U.S. merchant ships to step in as an integral element of Navy fleet support.

At present, the Navy relies on its own ships for fleet support despite the fact that extensive tests, and previous wartime experience, have shown that merchant ships can do the job. By 1990, for example, the Navy will have built at least 17 TAO fleet oilers at nearly $200 million per ship. With that same expenditure applied to similar commercial ships, perhaps 70 or more commercial ships could be built—a considerable improvement in versatility and redundancy—both important factors when wartime losses start to shrink our support fleet.

We have hundreds of tankers in our merchant fleet, yet only a handful have refueling rigs with trained operators ready to go. Every single one of these ships ought to be a potential Navy support vessel. Of course, these tankers would not be the perfect ship for the job, but if wartime losses make them the only ships for the job, we will be very happy that we had the foresight to make them ready.

I actually believe that the entire function of Navy fleet support should be turned over to commercial contract operation—under overall Navy command and control. This would include existing Navy fleet support ships. It would be cheaper. It would free up scarce Navy manpower for combat roles. It would increase the merchant marine work force. And it would make this work force a ready adjunct to the Navy, trained to work with the Navy in crisis or conflict. It would do in peacetime what necessity will require on the first day of war.

My fourth recommendation to increase defense impact of our merchant fleet would be to institute programs to enable merchant ships to provide some of their own security in wartime. Every merchant ship should be designed with the capability to have quick installation of gun emplacements, anti-submarine sensors, special communications, and other self-defense measures such as ASW helicopter platforms.

Finally, I would also devote resources and attention to programs that can turn some merchant ships into full-fledged combat vessels in war. The best known program of this type is ARAPAHO which is languishing in bureaucratic Siberia with little emphasis and miniscule funding. This is a distrubing fate for a program that really is no competition for the aircraft carrier but which could enhance so much of our sea control and convoy protection capabilities.

All of these programs, taken together, would greatly multiply the military resources available to the Navy and the country. They would be cheap at the price, certainly far cheaper than trying to do the job with military assets manned by military personnel. Above all, they would help match our capabilities to the threats our nation faces and the commitments we have undertaken around the world.

The measures I propose are not a pipedream. The British, during the recent Falklands War, have used some of them already. In this regard, I would highly recommend the book published late last year by the Naval Institute Press called Merchant Ships At War: The Falklands Experience by Captain Roger Villar. It details the close and highly-successful interaction of British merchant ships and personnel with their Navy. It provides, I believe, the combat-tested experience from which we ought to learn and upon which we ought to build.

In proposing the measures which I have mentioned above, I am not advocating that we turn the peacetime American merchant marine into a virtual garrison state. But we must find some way to multiply our military power. We do need to plan to use the merchant marine resources we do have at our disposal, as well as other national resources in other areas, much more intelligently—somewhat along the line that has proven so successful for Israel which can, in just a few hours, mobilize military power far greater than its standing military forces.

There are, I am certain, other steps we could take. Some would be quite unconventional, and probably all would meet some kind of bureaucratic and political resistance. But we owe it to ourselves—and indeed we have a responsibility—to think of defense and sealift with more flexibility and imagination. Our standing forces are—and will remain—finite. We face an opponent with global reach and formidable human and material resources. Our economy will not permit us to continue with the mentality that we can do it all with only regular military forces in-being. And in a future war time may not be on our side.

Senator **Stevens**. Admiral Holloway, accompanied by Mr. May, who is the executive vice president of the Council of American-Flag Ship Operators.

Let me announce, and I think Senator Inouye would agree with me, we will probably get through the next two witnesses, Mr. Klausner and Mr. Mills, today and we will schedule another day, hopefully next week or the week thereafter for continuing the witnesses and the hearing with regard to the subjects before us today.

Good morning.

STATEMENT OF ADM. JAMES L. HOLLOWAY III, U.S. NAVY (RETIRED), PRESIDENT, COUNCIL OF AMERICAN-FLAG SHIP OPERATORS, ACCOMPANIED BY ALBERT E. MAY, EXECUTIVE VICE PRESIDENT

Admiral **Holloway**. Good morning, Mr. Chairman. I am accompanied, as you noted, by Mr. Al May.

The Council of American-Flag Ship Operators, or CASO, represents the majority of the U.S.-flag liner companies serving in the foreign commerce of the United States. Our member companies own and operate a modern and diversified fleet of breakbulk, barge carrying, container, and roll-on/roll-off vessels, and all of these ships are available under various programs for use by the United States during times of military emergency.

Let me first comment on S. 102. CASO fully understands and appreciates the frustrations expressed by Senator Inouye when he introduced S. 102. It is absolutely imperative that U.S.-flag liner operators have the ability to acquire vessels at a capital cost equivalent to that of their foreign flag competition.

In addition, they must have the ability to make long-range plans based on a program that will truly provide such parity. Given the administration's position on CDS, we see foreign acquisition as a reasonable solution to the dilemma of the subsidized liner operator. Certainly CASO believes that if a CDS program could be structured to provide true capital cost parity, and operators had some assurance that it would remain in place over a period of years, that would have to be looked at as another possible solution.

However, acquisition of foreign-built vessels by U.S. subsidized liner operators must be permitted until such a program is actually in place. Support for the authority of subsidized U.S. operators to acquire vessels on the world market has been the cornerstone of the administration's maritime policy since its introduction in 1983. But, unfortunately, legislation to implement this policy has been frustrated. In our view, this cannot be permitted to continue.

CASO believes that the first step in the resolution of the problem that beset the merchant marine shipbuilders is to clearly separate these two individual industries, both in the minds of the American people, and in the congressional actions designed for their support. Each is a unique line of business with its own special characteristics and economic considerations, and each must be treated separately if a resolution to their endemic ills and immediate problems is to be found.

Both are essential. Both are needed in the best security interests of this country, and both are vitally important to our national economic strength.

We have reviewed S. 679 in the administration's request for the Maritime Administration for operating differential subsidies, research and development, and operations and training. We agree with the sponsors of S. 679 that it is premature for the administration to assume any savings to the ODS Program as a result of a yet-undefined and we believe ill-advised subsidy recapture system.

We also agree that it is speculative, at best, to assume savings in the amount the administration has projected as a result of ongoing negotiation to improve the ODS payment system. Certainly there will be savings, but it is too early to attempt to quantify. We therefore support the full ODS authorization of S. 679.

CASO believes that ODS contracts may impose unnecessary constraints on operating flexibility, constraints that were not anticipated when they were signed many years ago. For example, the essential trade route system should probably be modified to permit operators to better utilize their vessels in intermodal systems if this can be done without creating inequitable advantage or hardship.

CASO currently has under review a DOT proposal on trade areas, and if CASO's early understanding of that proposal is correct, it would be a first step to assist carriers by providing increased operating flexibility at no cost to the Government, while keeping competitive advantages or disadvantages to a minimum.

CASO looks forward to working with the administration in its implementation. CASO members and the Maritime Administration have recently been discussing a subsidy simplification program to improve accounting systems for the determination of subsidy payable and to reduce contract costs for MarAd and operators.

The principal objective of this program is to develop a per diem subsidy rate for each vessel which would include the wage subsidy and, as appropriate under individual contracts, other costs. We believe it is in keeping with the concepts of period accounting and a subsidy simplification program that earned subsidy be paid on vessel-day basis. We understand that the Department of Transportation is moving toward this goal and, as with trade route simplification, we look forward to working with them toward its implementation.

Against the current background of declining capabilities and growing requirements, it is obvious that some significant actions must be taken to improve the sealift component of our strategic resources. We as a Nation must be concerned with the erosion of our U.S.-flag liner fleet capabilities, and we must be prepared to support whatever actions are necessary to halt this decline and restore the U.S. merchant marine to a position of economic strength and strategic capacity adequate to fulfill the industrial and military requirements of the United States.

Mr. Chairman, that concludes my oral testimony. I have submitted for the record a statement which expands on the points that I have made orally.

Senator **Stevens**. That will be placed in the record.

What are your views about the administration's three proposals to change the operating differential subsidy?

Admiral **Holloway**. We feel that it has substantial merit, and that we look forward to working with the MarAd in its development and implementation.

Senator **Stevens**. The double subsidy, too?

Admiral **Holloway**. We think that double subsidy is an ill-conceived step. As Mr. Calhoon pointed out, if double subsidy were to be applied, there is a very strong possibility that it is going to eliminate one or more of our existing seven liner companies. That is how tenuous the situation is today, Mr. Chairman.

Senator **Stevens**. I assume that you oppose that 5 percent origination fee in title XI?

Admiral **Holloway**. I would like to ask Mr. May to talk to that. He is very well acquainted with it.

Mr. **May**. Yes, sir; we do oppose it for the reasons that have already been put on the record today. We would add this: If it is determined that there has to be some increase in order to make the whole program more economically viable, then there should be a range of fees based upon economic projections as to the security of the projects to be guaranteed.

In other words, the fee might be related to the safety of the project, which we think is what the Maritime Administration is trying to do. However, we do not see any reason to increase fees. The entire purpose of title XI is, through the Government guarantee, to give the U.S. operator a lower interest rate that is near to what the foreigner gets. You are simply undermining the entire philosophy of title XI by increasing the fees.

Senator **Stevens**. Thank you very much.

Senator Inouye.

Senator INOUYE. Mr. Chairman, I have several questions I would like to submit to the admiral for his consideration and response, but I would like to ask one for the record.

Admiral, in your prepared statement you say and I quote:

> Similarly, efforts to re-flag passenger liners for the domestic trade, and to authorize the pay back of operational differential subsidy to allow tankers to participate in the Jones Act trades were defeated by elements of the maritime industries which would not have benefited from their passage.

Is this part of your statement?

Admiral HOLLOWAY. No, sir; it is not. That was in an earlier draft. We asked the staff to remove that statement because it was being totally misinterpreted. To be straightforward with you, Senator, CASO has not taken a position in this area because it does not affect us directly.

The purpose of the statement was an effort to demonstrate the fractionization that exists among all of the maritime interests, and I think it was an ill-advised example. I realized I had made a mistake, and I asked the staff to remove that statement. The paper that I have submitted for the record does not include that.

Senator INOUYE. Thank you very much.

Senator STEVENS. Thank you.

Senator Trible.

Senator TRIBLE. Thank you, Mr. Chairman.

Admiral Holloway, it is a great pleasure to see you again. I remember first listening to your testimony when you were the Chief of Naval Operations, and I a young Congressman. I am now a young Senator, and you are a young advocate of the maritime industry. I am glad we can continue to meet in these circumstances.

Admiral, in your testimony you say that the shipbuilders had stymied all build-foreign proposals. It seems that the current situation helps no one. You have made this point in your testimony. There are no commercial contracts, no commercial ships under contract, perhaps no commercial ships under construction in the United States. At the same time, the U.S. subsidy operators try to compete with an aging and increasingly inefficient fleet.

If this deadlock continues, these two vital industries are in a lose/lose situation, and along with it our national interest will suffer, and is suffering mightily.

How do we deal with this problem? You say that simple solutions have been complicated by political realities. You have indicated your willingness and firm commitment to work with the maritime industry, the administration, and the Congress. Is there not some way that we can reconcile the obvious national interest in maintaining a vital shipbuilding base, a point that you made time and time again when you were Chief of Naval Operations?

At the same time, the obvious national requirement is that we have ships flying the American Flag.

Admiral HOLLOWAY. Yes, Senator. I think that I have to agree with everything that you say. I have made those statements. We are willing to work with the shipbuilding industry and with the administration. But I think there are a couple of points that need to be made.

The commercial operators alone cannot support a U.S. shipbuilding industry. Last year, I do not know what the exact figure was, but I think the Government put $18 billion into the shipbuilding industry in U.S. Navy contracts. What is being proposed is $300 million in ODS which, at a 60 percent cap, would amount to a half a billion dollars that the commercial operators would contribute toward the support of this vital industry.

But, Senator Trible, I would like to make another point. Today the private operators are building ships similar to the U.S. lines giant container ships, 65,000 tons displacement, a length of well over 1,000 feet. Ships of this size, capacity and complexity can only be built in a few U.S. shipyards. And the shipyards that can build these large modern commercial ships that the industry wants, tend to be the same yards that can build the ships for the Navy.

I think we have a deeper problem. If we want to support a very broad-based shipbuilding capability, then we have got to find some other way to subsidize those fringe companies that are going to be important in time of conflict to build the smaller patrol-type craft that we will want to produce as we approach a national emergency.

The operators, even with a 60 percent cap on a construction differential subsidy, will not take advantage of CDS. Because it means if a foreign built ship can be acquired at one-third the cost of a domestic ship, under a 60 percent cap the domestic operator still must pay 20 percent more for a U.S. ship built under CDS, than he could by acquiring overseas.

I said earlier, the financial situation is so tenuous for ship operators, that for those operating on a thin margin, 20 percent could be the difference between success and failure. It is not a question of patriotism on the part of the operator to build his ship in the U.S. under these circumstances. He is not being patriotic if he puts himself into bankruptcy and puts his company out of business.

I think in the majority of cases, that is what would happen.

Senator TRIBLE. Well, I do not know how we reconcile the problem that you and I have sketched. As someone who is obviously interested in shipbuilding, I must confess that I cannot see how we can support and maintain as many shipyards as we have in this country. Fortunately, most of my shipyards can survive. Perhaps that is why I am able to make that statement. Not all of them will.

I think it is desperately important that we have more American-flagships, and when they are available in the world market it is very difficult to argue against acquiring them. We are going to have to break out of this present posture, because it is so obviously self-defeating.

I really do not know how it can be achieved, though, absent—Congress cannot do it. Congress has not demonstrated the ability to agree on many things, and we surely are not going to agree on a comprehensive maritime strategy, in spite of the leadership of my colleagues on this committee, and I would say that most respectfully.

It really will require the strong leadership of some administration. This administration is not much interested in maritime matters. There are obviously a lot of important issues competing for the time, the attention, and the limited political capital that is available.

I would like to think, though, that will all the talent this room holds, on both sides of the bench, that we could put forward some strategy that would keep our shipbuilders strong at least in adequate number to meet our national interests, and yet expand and strengthen our maritime presence around the world.

Anyway, I continue to be interested. I continue to show up for these hearings. I continue to hear the same testimony year after year, and we continue to get nowhere. But I will look forward to working with you this year, and hopefully incrementally if not in some revolutionary fashion, we might get something accomplished.

Thank you, Mr. Chairman. I appreciate your patience.

Senator STEVENS. Thank you.

Let me tell Mr. Klausner and Mr. Mills we will have to schedule you in the next hearing, too, because we do have a meeting at noon.

Senator Rockefeller.

Senator ROCKEFELLER. I have no questions.

Senator STEVENS. I want to thank you, also, admiral. I would hope that your council would start now to participate in these discussions that are going on and see if we cannot get the industry initiative that everybody is looking for.

What is your feeling about the recommendation of the Jones Act study?

Admiral HOLLOWAY. Because CASO represents the U.S.-flag operators in foreign trade, we have maintained an arms-length relationship with any proposed changes to the Jones Act. But having said that, nevertheless I believe that it is time for CASO to look at any specific Jones Act recommendations, because it is now clear that those recommendations are going to affect our companies. So I think it would be not only proper but necessary for us to examine the ramifications of the outyear effects of such proposals on our member organizations.

What I can say in a positive way today is that I will recommend to my principals that we examine any proposals for alterations in the Jones Act and be prepared to make suggestions and recommendations in response to any questions you might have of us.

[The statement follows:]

STATEMENT OF ADM. JAMES L. HOLLOWAY III, U.S. NAVY (RETIRED), PRESIDENT, COUNCIL OF AMERICAN-FLAG SHIP OPERATORS

Mr. Chairman and members of the committee, I am Admiral James L. Holloway III, President of the Council of American-Flag Ship Operators (CASO). I am accompanied today by Albert E. May, Executive Vice President and General Counsel of CASO.

CASO represents the majority of the U.S. flag liner companies serving the foreign commerce of the United States. Our member companies own and operate a modern and diversified fleet of breakbulk, barge-carrying, container and roll on/roll off vessels. All of these ships are available under various programs for use by the United States during time of military emergency.

We appreciate the opportunity to appear here today to present our views on S. 679 and S. 102.

Mr. Chairman, before addressing the authorization request, however, the members of CASO would like to take this opportunity to commend the members and staff of this Committee for the important role which you played in securing passage of the Shipping Act of 1984.

The enactment of the Shipping Act of 1984 marked a major milestone for the U.S. merchant marine and represented the culmination of seven years of effort on the part of the industry, the Congress, and two administrations. The regulatory reforms included in this act will contribute toward the economic recovery of the merchant marine by enabling it to compete on a more equal basis with its foreign flag counterparts.

1. S. 102. Once again, the Administration has requested no funds for ship construction subsidies. As stated in the President's budget message:

"* * * The Administration again proposes several initiatives to help revitalize the Maritime Industry. Included are legislative and administration changes that would streamline or eliminate many of the restrictions under which the U.S. Merchant Marine now operates, thereby reducing costs. One of the most significant elements of the Administration's policy is to permit subsidized U.S.-flagship operators to build or acquire modern, efficient ships in a cost effective and timely manner."

This support for the authority of subsidized U.S. operators to acquire vessels on the world market has been the cornerstone of the Administration's Maritime Policy since its introduction in 1983. Unfortunately, legislation to implement this policy has been frustrated because of opposition from the Shipbuilders Council of America and others. The liner companies have been held as hostages during the debate on this issue. Many of the vessels now in our fleet were built in the 1960's and early 70's. Their owners suffer the burden of operating these ships against competition that has moved to more fuel efficient vessels with large diesel engines that have reduced fuel costs by more than 30%, and fuel is the largest element of our vessels' operating cost. Automation advances permit our foreign competitors to man their ships with 18 to 20 man crews, about half the complement of our 1960's built vessels, and crew costs are the second largest element of vessel operating cost.

All must now accept that in the absence of a construction parity program it is impossible for U.S. liner operators to build vessels for the foreign trade in U.S. shipyards because of differences in cost, technology and construction time. Without an orderly program of fleet modernization, in which older steam driven, breakbulk, labor intensive ships are replaced with new, economical diesel powered, highly mechanized cargo ships with substantially reduced crew sizes, U.S. operators will simply not be able to maintain a modern, competitive, U.S. flag fleet. Last year in testimony before this committee we noted that this is an issue where simple solutions, for political reasons, have become incredibly complex, and that sorting them out would require a firm commitment on the part of the various segments of the maritime industry, the Administration and the Congress. We then pledged that commitment and again so pledge. Inaction by the Congress on this Administration proposal helps no one. Positive action would hurt no one. It must be done.

Mr. Chairman, we fully understand and appreciate the frustration expressed by Mr. Inouye when, on behalf of himself and Mr. Long, he introduced S. 102. It is, as we have said earlier, absolutely imperative that the U.S. flag liner operators have the ability to acquire vessels at a capital cost equivalent to that of their foreign flag competition. In addition, they must have the ability to make long range plans based on a program that will truly provide such parity. Given the Administration's position on CDS, we see foreign acquisition as a reasonable solution to the dilemma of the subsidized liner operator. Mr. Inouye succinctly stated that dilemma in his introductory remarks to S. 102 when he said "This fleet has replacement obligations and must be updated and modernized." Certainly, if a CDS program could be structured to provide true capital cost parity and operators had some assurance that it would remain in place over a period of years, that would have to be looked at as another possible solution. The problems, however, are many. Raising the allowable CDS ceiling from 50 to 60% is probably not sufficient. Our latest information is that liner type vessels would cost upwards of three times as much to build in the United States as to build abroad. In addition, construction time in U.S. shipyards is at least twice as long and state of the art technology, principally in diesel propulsion systems, is not available to operators building in U.S. shipyards. These are not easily resolved impediments to providing true cost parity. It will take more than money alone. We sympathize with the plight of those commercial U.S. shipyards which are currently experiencing financial difficulties. It must be remembered, however, that the operators likewise are and have been experiencing difficulties. Since 1970 the number of U.S. flag liner operators has dwindled from 19 to 7. While we certainly stand ready to work with this Committee and others on the implementation of any program that would provide true parity, vessel operators cannot continue to be denied an opportunity to upgrade and renew their fleets. Acquisition of foreign-built vessels by U.S. subsidized liner operators must be permitted until such a program is actually in place.

Mr. Chairman, before leaving discussion of S. 102 we should point out that the wording of the bill appears to go beyond authorization of appropriations for a traditional construction-differential subsidy program and might be read to authorize funds for the acquisition by DOT of commercial vessels which might then be chartered out and operated in competition with existing vessels. We understand this is not the intent of the bill but we must state that any such possible result would have to be very closely examined and, most probably, would be unacceptable.

2. S. 679. We have reviewed S. 679 and the Administration's request for authorizations for Operating Differential Subsidies, Research and Development and Operations and Training. It is premature for the Administration to assume any savings to the ODS program as a result of an as yet undefined and, we believe, ill-advised subsidy recapture system. It is speculative at best to assume savings in the amount the Administration has projected as an early result of ongoing negotiations to improve the ODS payment system. Certainly there may be savings from a more timely payment system, but it is too early to attempt to quantify them. We therefore support the full ODS authorization of S. 679.

The Administration's budget continues funding for contracts now in effect to "* * * provide operating subsidies to offset the higher costs of operating U.S.-flag vessels". It is the stated policy of the Administration not to enter into any additional operating subsidy contracts. There have been suggestions made that it would be in the best interest of the government and some operators should existing contracts be renegotiated. If so, CASO would certainly be supportive but we will leave specific comment on this issue to our member companies.

While some have criticized the ODS labor cost parity program, the only validity to any of the arguments we can find is that it may impose unnecessary constraints on operating flexibility that were not anticipated when ODS contracts were signed many years ago. At that time there were up to twenty liner operators who held ODS contracts and today's sophisticated intermodal systems, which have revolutionized liner shipping, were still on the drafting table. There are now only six ODS liner operators serving all U.S. trades, so it can readily be seen why changes are needed.

For example, the essential trade route system should probably be modified to permit operators to better utilize their vessels and intermodal systems if this can be done without creating inequitable advantage or hardship. We currently have under review a DOT proposal on "trade areas" that would help accomplish this. If our early understanding of this proposal is correct it would be a first step to assist carriers by providing increased operating flexibility at no cost to the government while keeping competitive advantages or disadvantages to a minimum. We look forward to working with the Administration toward its implementation. In addition, Maritime Administration and carriers with operating differential subsidy contracts have recently been discussing a "Subsidy Simplification Program" to improve accounting systems for the determination of subsidy payable and to reduce contract costs to MARAD and operators. The principal objective of this program is to develop a per-diem subsidy rate for each vessel which would include the wage subsidy and, as appropriate under individual contracts, other costs. As part of this simplification program, vessel-days rather than terminated voyage days are recognized in the preparation of vouchers for subsidy payable under the contract. It would be in keeping with the concept of period accounting and the subsidy simplification program that earned subsidy be paid on a vessel-day basis. Our counsel has advised us that in his opinion the Secretary of Transportation has the authority to authorize such payment. Prompt payment of a per-diem subsidy will be mutually beneficial and eliminate protracted withholding of funds pending determination of "final" rates, which historically has extended over periods of 4 or 5 years. These long delays affect the government budget process and are reflected in large accounts receivable on the contractor's balance sheet. We understand that the Department of Transportation is moving toward this goal and, as with trade route simplification, we look forward to working with them toward its implementation.

Mr. Chairman, as I mentioned earlier, enactment of the Shipping Act of 1984 marked a major milestone for the U.S. merchant marine.

However, regulatory reform alone cannot produce an economically viable national merchant marine engaged in foreign trade. To compete effectively, the American merchant fleet must be equipped with new, modern, fuel efficient ships, with mechanized cargo handling facilities to reduce turn-around times, and automated ship installations to improve the efficiency of crew operations. Today less than 15% of U.S. cargo ships are equipped with modern slow speed diesels, whereas 99% of the Japanese commercial fleet and 97% of the German are so equipped. The U.S. merchant marine clearly is in need of modernization. 30% of the U.S. flag liners are over twenty years of age compared to 3% of the Japanese and 1% of German cargo ships.

A full recovery of the U.S. flag merchant marine would also require a clearly defined and positive national cargo policy. Most other nations with large merchantile fleets support their merchant marines with national policies which reserve—either by law or tacit understanding—a major share of their foreign trade to their own flag shipping. As a starting point, we in the U.S. must cease further erosion of the existing preference laws for government generated cargo, and then develop and support a maritime cargo policy, which through verious measures—bilateral trade agreements for example—will generate the same national support for a U.S. flag merchant merine as that enjoyed by our competition in the foreign trade.

The main reason for public support of a U.S. flag merchant marine is its utility as the nation's strategic sealift force in times of war and national emergency. There is an economic justification for a national flag merchant marine, particularly to protect the interests of U.S. exporters, but it is more difficult to quantify and the rationale is endlessly debated by economists within our own government. On the other hand, the military necessity for a U.S. flag merchant fleet for sealift purposes is disputed by no informed person in a position of responsibility.

Military sealift has taken on a sharply increased level of importance in the evolving strategy of the United States, and is receiving special emphasis in our defense planning. Sealift is absolutely essential to the success of our military strategy and to the execution of our military contingency plans. There is no plan for any major overseas military operation, whether it be general war involving the Soviet Union, or a contingency operation is ome remote corner of the globe, that does not involve the use of the seas for the injection of our military forces and the sustaining of American presence in the area.

In 1983 the Office of the Secretary of Defense and the Department of the Navy engaged in several studies relating to sealift and shipbuilding in order to formulate a basis for new intitatives in the avea of maritime policy. The long standing problems associated with our U.S. flag shipping and shipbuilding industries were recognized as beginning to impact adversely on national security.

Of the study effort relating to sealift, only the part dealing with the movement of general cargo has been completed.

The military dry cargo requirements for U.S. flag sealift were derived from the Southwest Asia portion of a global war. To meet the Southwest Asia needs, sufficient shipping capacity must be available from U.S. flag sources to fulfill the requirement for 4.6 million deadweight tons (MDWT) of shipping for surge operations, and an additional 3.3 MDWT for sustaining operations.

At the present time only about 2.9 MDWT—60 percent of the 4.6 MDWT requirement—is available from current assets, of which the U.S. flag merchant marine contributes about 2 MDWT. By 1988 the U.S. flag's sealift position is expected to improve to the point where it can handle about 90 percent of the requirement. The improvement will come mainly through an expansion of the Ready Reserve Force and the utilization of seasheds and flatracks. This latter program, under which U.S. flag containerships will be modified during a contingency to carry military unit equipment will, through increased efficiency, contribute the equivalent of an additional 0.8 MDWT.

To grasp the full impact of the foregoing figures, it is essential to understand that the entire capacity of the U.S. flag merchant marine would be utilized. No vessels are withheld from military service to continue the movement of commercial cargoes along ocean trade routes. U.S. comemrcial shipping would be, in effect, abandoned.

This inability of U.S. flag sealift assets to satisfy current military strategic lift requirements is of substantial concern to the Department of Defense. In a letter to the Secretary of Transportation, Secretary of Defense Weinberger said:

"The decline of the U.S. Martime industries over the past several years has generated significant interest in the merchant marine's capability to support the President's national security objectives.* * * The decline in U.S. flag commercial shipping capable of carrying military unit equipment is of particular concern to DOD. * * * Even assuming that the entire U.S. merchant marine is made available to support military requirements, we may not be able to meet DOD's limited policy objectives.

"A merchant marine, even if it were capable of supporting military operations, may not be adequate to satisfy all of our national security requirements during a major conflict. I have not included the civil economy and the industrial base in DOD's statement of maritime requirements." (24 April 1984)

So, according to the Department of Defense, the capacity of the U.S. flag merchant marine to carry out its defense responsibilities for strategic sealift is today inadequate and is projected to be marginal in the future. The reason is if the continuing reduction in the size of the American commercial fleet.

Against this background of declining capabilities and growing requirements, it is obvious that some significant actions must be taken to improve the sealift component of our strategic resources. We as a nation must be concerned with the erosion of our U.S. flag liner fleet capabilities, and be prepared to support whatever actions are necessary to halt this decline and restore the U.S. merchant marine to a position of economic strength and strategic capacity adequate to fulfill the industrial and military requirements of the United States.

The main thrust of such a maritime effort should be regulatory reform, increased cargoes, and fleet modernization and replacement.

Regulatory Reform has been partially accomplished through the Ocean Shipping Act of 1984 which goes a long way toward removing the restrictive burdens currently imposed on U.S. flag carriers.

Increased cargoes will result in some degree from the improved competitive position deriving from regulatory reform and fleet modernization, but there still remains the problem of competing with foreign carriers which benefit from national policies affording various forms of cargo preference and subsidization. The response to subsidized foreign competition should be two-fold: first, to require meticulous compliance by all U.S. government agencies to our own current cargo preference laws which reserve certain portions of government impelled cargoes to U.S. flag vessels; and second, the extension of bilateral agreements such as those now in effect with Brazil and Argentina.

Fleet modernization requires the construction of new vessels or the modification of existing ships to provide replacement vessels with significantly improved efficiencies in propulsion systems, manning levels, and cargo handling equipment. With U.S. built vessels costing more than three times as much as identical ships acquired in foreign yards, this replacement program can only be effected by allowing all U.S. operators to acquire modern vessels on the world market. The offshore liner industry is unique in the fact that it is exclusively engaged in international trade and therefore in direct competition with foreign shipping. Having no domestic market base, the U.S. flag liner companies must have capital costs comparable to their foreign competition.

Probably the single most important element in the recovery—or perhaps the survival—of the U.S. merchant marine is the need to modernize the liner fleet. The relatively small steam turbine powered breakbulk freighters with 38 to 42 man crews, which constitute such a large portion of the U.S. operators' inventory, are simply not competitive with the larger modern diesel freighters with automated cargo handling features and unmanned engine rooms that require only a crew of 20 to 22. The cost effectiveness of a 10,000 DWT C-4 breakbulk freighter with a crew of 42 suffers dramatically in comparison with a new superfreighter of 58,000 DWT and a capacity of more than 4400 20 ft containers, powered with economical low speed diesel engines and manned by a crew of 22.

During 1984 there were a number of initiatives to generate legislation that would help resolve the ills of the U.S. merchant marine. However, only one piece of significant legislation succeeded, the Shipping Act of 1984. All of the other major attempts at remedial legislation failed. The inability of the Congress to assist the several segments of the maritime industry was largely the result of the very disparate nature of the industry's components. Too often the merchant ship operators, the shipbuilders, their associated labor groups and suppliers are thought of as a single industry. This is far from fact. The merchant ship operators and the shipbuilders represent two distinct industries with diverse characteristics, interests, and objectives. The very nature of their businesses separates the two, just as the aerospace industry and the airlines are totally separate commercial entities. In many cases, legislation proposed to help one maritime group was defeated through the efforts of another group of maritime interests.

As previously noted, the authority for subisidized liner operators to acquire their ships overseas is essential to the survival of these companies in the absence of contruction differential subsidy. The enactment of legislation to authorize foreign building has for the past two years been a major element in this Administration's maritime program. However, efforts to pass this enabling authority were opposed by shipbuilders, some maritime labor unions, and some non-subsidized carriers. Similarly, efforts to re-flag passenger liners for the domestic trade, and to authorize the pay back of operational differential subsidy to allow tankers to participate in the Jones Act trades were defeated by elements of the maritime industries which would not have benefitted from their passage.

This tug-of-war within the Congress to achieve remedial legislative action is neither unique nor new to the maritime industry. But unless some solution is discovered that can benefit one sector without doing vital damage to another, the impasse is going to continue.

Probably the first step in the resolution of the problems that beset the merchant marine and the shipbuilders is to clearly separate these two individual industries, both in the minds of the American people and in the Congressional actions designed for their support. Each is in a unique line of business with its own special characteristics and economic considerations, and each must be treated separately if a resolution to their endemic ills and immediate problems is to be found. Both are essential to the best security interests of this county and both are vitally important to our national economic strength.

Mr. Chairman, that concludes my prepared remarks.

[The questions referred to follow:]

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question. Admiral, from your testimony I gather CASO favors MarAd's proposal to give blanket authorization to subsidized operator to engage in nonsubsidized operations. Couldn't that proposal help some of your members at the expense of other members. Let me illustrate.

(a) For example, Farrell Lines is presently required under its ODS contract to make 44 sailings per year on a route between the U.S. Atlantic Coast and the Mediterranean with three vessels. Wouldn't MarAd's proposal permit a large subsidized company to provide nonsubsidized service on that same trade route even though a small company like Farrell could not possibly compete? In other words, what control would you have over a large subsidized operator by using nonsubsidized sailings where a small subsidized company cannot hope to compete?

(b) Along these same lines, isn't it inconsistent for the government to support a liner through ODS and then threaten its stability by placing it in an environment in which it can't compete? In that event, won't this proposal create a competitive situation which will threaten the government's multi-billion investment in ODS?

Answer. I don't see how one can, from CASO's testimony, draw the conclusion that CASO favors a proposal to give blanket authorization to subsidized operators to engage in nonsubsidized operations. The question appears to go to issues which are before the courts. Therefore, it would be inappropriate for CASO to comment on those issues.

Question. Admiral, CASO's testimony appears to urge the foreign acquisition of ships by subsidized operators and the continued payment of subsidy for these vessels. It was my understanding, having met with the CEO's of the seven principal American-Flag liner operators, that they have been trying to formulate a proposal which would establish a level playing field for liner operators. I am sure you are aware of this. I am sure you are also aware that this cannot be achieved with this kind of build foreign program. Therefore, isn't that kind of build foreign proposal a divisive influence at a time when the operators are trying to get together?

Answer. CASO's prepared statement endorses the Administration's proposal that when shipyard subsidies are not available, ODS contractors should be permitted to acquire ships abroad. This in no way changes the fundamental relationship between members of the U.S. flag liner industry. The ODS contracts entered into under the terms of the Merchant Marine Act of 1936 always intended that ODS contractors would be able to procure vessels at world cost.

In order to support the U.S. shipbuilding industry, these contracts required ODS operators to build vessels in the United States. However, they provided that an operator should notify the Maritime Administration of the nation in which it would construct vessels if it were legally authorized to do so. The Maritime Administration then determined the actual cost of the vessel in the designated low cost foreign shipbuilding center. This is the price that the operator paid. The additional cost of building in the United States was intended to be paid by the government directly to the U.S. shipbuilder from construction differential subsidy funds.

When the Administration determined not to fund the CDS program, it proposed that ODS operators be permitted to build abroad so that they could continue to secure vessels at the world price as had always been intended.

Thus, authority to build abroad does not confer some new benefits or privilege on ODS contractors.

Senator **STEVENS**. Thank you very much.

My apologies to Mr. Klausner, Mr. Mills, Admiral Miller, Admiral Swarztrauber and Admiral Scarborough. We only have 10 minutes left. That would not be adequate time to hear your concerns, and I think we ought to hear the testimony on both sides of these issues at the same hearing. So we will continue this hearing, and we will notify the remaining witnesses of the time and schedule. Thank you all.

Admiral **Holloway**. Thank you, Mr. Chairman.

[Whereupon, at 11:50 a.m., the hearing was adjourned, to reconvene at the call of the Chair.]

MARITIME APPROPRIATION AUTHORIZATION ACT FOR FISCAL YEAR 1986

FRIDAY, MARCH 29, 1985

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Subcommittee on Merchant Marine,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:20 a.m. in room SR-253, Russell Senate Office Building, Hon. Ted Stevens (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR STEVENS

Senator Stevens. Good morning.

This is a continuation of our subcommittee's hearing on S. 679, the fiscal year 1986 maritime authorization bill, and S. 102, authorization for the construction differential subsidy.

Last week we were unable to hear all the witnesses scheduled to testify on these bills because of time constraints. I apologize to the witnesses who were inconvenienced by the delay, and appreciate your returning today.

Those of you who were here for the first part of the hearing will recall that we were presented with a number of useful suggestions, including one that the time is now ripe for a comprehensive study of the Jones Act. I agree with that wholeheartedly. Our cabotage laws date back to the Continental Congress. They now need to be carefully examined to see if they have adequately served the needs of our domestic commerce and have distributed the costs which those laws impose upon our citizens and taxpayers in a fair and equitable manner. Such a study will undoubtedly take time and much effort in view of the complexity of the issues involved. In the meantime, there are pressing issues affecting our domestic commerce which cannot be held in abeyance and will have to be addressed by this Congress. To do otherwise would abrogate the duties of this subcommittee. Given the history of these laws I expect that the near term changes, if any, would be evolutionary rather than revolutionary and therefore, easily integrated into our study of the broader issues.

Before we hear the first witness, let me first defer to my good friend from Hawaii.

OPENING STATEMENT BY SENATOR INOUYE

Senator Inouye. Thank you very much, Mr. Chairman.

As the subcommittee concludes hearings on the MarAd authorization, I wish to commend our distinguished chairman for his initiative in accepting Mr. Calhoun's recommendation at last week's hearing, that we undertake a comprehensive review of the Jones Act, and to reemphasize my own support for such a study. Every year proposals are made for ad hoc amendments to that act, and we are faced with the dilemma of doing nothing or chipping away at one of the foundations of our maritime policy without knowing what the long term consequences might be.

I believe that the time has come for us to make a comprehensive examination of the Jones Act and the reasons for it, so that we may decide once and for all if it is serving the purposes for which it is intended; and, if not, what can be done to improve it. The Jones Act should apply equally to everyone.

I also wish to commend our distinguished chairman for scheduling a hearing on the Maritime Administration's tentative proposal to revise the present essential trade route structure which is the basis for the contracts under the statutory operating differential subsidy program. The potential impact of such a change on our liner fleet and the ODS Program may be so fundamental that Congress really ought to have a chance to review any proposal before it goes into effect.

Finally, I would like to take the opportunity to correct an inadvertent error in last week's hearing. The Vice Chairman of the Federal Maritime Commission, in response to questions from the subcommittee, testified that the FMC had not been involved with the administration's efforts to develop a proposal to deregulate our domestic offshore trades. Subsequently, in conversations with my staff, Vice Chairman Carey said that at the time he was unaware that several key members of the FMC's staff had been discussing the matter with the administration, and that he would revise his answer in the record to reflect that fact.

At last week's hearing, the MarAd witness was unable to explain why the administration felt domestic deregulation was necessary, and since the FMC is the agency charged with regulating our domestic trades, I thought it might be able to shed some light on why the administration felt deregulation was needed. That was the reason for my question to Vice Chairman Carey at the time.

Senator STEVENS. Our first witness is Joseph Klausner, counsel for the American Maritime Association. We are happy to see you here, and we would like to have you proceed as you wish.

STATEMENT OF JOSEPH A. KLAUSNER, COUNSEL, AMERICAN MARITIME ASSOCIATION, ACCOMPANIED BY JACK GOLDSTEIN, VICE PRESIDENT, OVERSEAS SHIPHOLDING GROUP, INC.; AND WILLIAM C. FOSTER, COUNSEL, PATTON, BOGGS & BLOW

Mr. KLAUSNER. I am accompanied by Mr. Foster, my cocounsel, and by Mr. Goldstein, who is vice president of Overseas Shipholding Group and its chief economist.

The domestic tanker industry has been going through a severe adjustment to market conditions that has been described as the worst in 50 years. It says something for the commercial flexibility and adaptability of the industry that just as it expanded rapidly with over 4 million tons of new tankers to meet the growing demand of the 1970's, chiefly for the Alaska trade, it has contracted quite ruthlessly and without self-pity in the face of declining conditions. In the 3 years, 1982 through 1984, 65 ships were deleted from the fleet totaling 1.9 million tons. By the end of this decade, we expect a further net deletion of 1.3 million tons. Allowing for some new construction, the domestic fleet may be down to roughly 140 ships of about 9 million tons by that time, a decline from over 11 million as recently as 1982.

That is certainly a classic demonstration of free market adaptability, both up and down. No one will suppose that the down side has not been painful, even ruinous to some. Nor has it been without serious consequences for the national defense, in our opinion. But the members of the industry have had to accept the play of market forces because they chose to make their investment in that market.

We have not even yet reached a new equilibrium at the modified low levels of demand. The best we can say, at a time when a million tons are still laid up, is that we may be approaching such a balance, and that some long-term factors of a favorable character are discernible which tend toward achieving it. The coastwise products trade being in a permanent declining trend, and few opportunities for unsubsidized tankers remaining in any of the preference trades, into which, moreover, the Maritime Administration is flooding subsidized ships, these favorable factors are almost entirely concentrated in Alaska and on the West Coast.

It is therefore with renewed urgency that the association's members come before the committee, Mr. Chairman, to argue once again against Government interference with this delicately poised market. For 3 years there has hung over them the threat that the whole subsidized fleet would be turned into the domestic trade. Twice Congress has temporarily arrested this plan of the Department of Transportation, most recently through a period ending May 15, 1985. The current suspension was thought by many shippers to imply the end of the threat. For the first time in some years they were willing to commit to coastwise tonnage for substantial periods, and Exxon contracted to build two VLCC's in an American yard. The proposed rule has not been withdrawn, however, and may be immediately impending. Subsidized ships are in fact being offered effective after May 15.

From what I have told you, the consequences of flooding this market with an additional 4 million tons of shipping are obvious. The whole destructive process would start from the beginning. And this time it would not be the natural forces of the market that would be responsible, but the very Government some of whom say they respect the marketplace as the best disponent of economic resources.

The members of the association have sought, with other responsible groups in the industry, to find a resolution for the time being to this debilitating and dangerous controversy. When we were scheduled to testify before your committee last week, we had in mind to propose a temporary measure to operate while Congress considered a permanent disposition. Sitting here in your committee room, we heard the discussion in which the Chairman and ranking members of the committee indicated that they agreed that the time has come for a fundamental study of the coastwise trades.

It is certainly the case that national shipping policy has been undergoing profound changes, including marked departures from the established statutory framework without the close consultation with Congress that might have been expected. The chairman and ranking members of this committee have intimated disquiet at this process, and their view is evidently shared by other concerned Members of the Senate.

The optimistic utterances of the Maritime Administrator last week correspond to no opinion of the general state of the industry that I have anywhere heard expressed. There is no doubt that at a time of deep depression, the Department of Transportation is moving to withdraw or drastically modify most of the established Federal supports, including subsidies in the foreign trade and the system of mortgage guaranties. It is in this context, we believe, that the plan to allow entry of subsidized ships into the coastwise trades must be recognized as fitting.

The members of the association would therefore welcome a direct congressional study of the problems of the domestic trade. It is just such a tribunal of the actual architects of the national shipping policy that we consider has all along been wanting. The framers of the policy should examine its state. We cordially endorse this proposal.

Only since the general collapse of the foreign trade has Government interest tended to focus on the coastwise trade, and it might almost seem to exploit it to help the subsidized fleet. Over many years, the maritime agency perhaps naturally concentrated attention on its main job, which was distributing and administering subsidies. The sector of shipping that asks little or nothing received little or no notice. Yet that sector had at the outbreak of the great wars constituted the preponderant merchant armament. For World War II, over half the ready liner fleet and all the tankers emanated from coastwise service. Although the weight of the liner fleet has swung to the foreign trade, the bulk carriers retain their traditional main fulcrum in the domestic trades.

Dwelling within the sphere marked out by the historic coastwise laws, to which the chairman has alluded, the tanker industry has developed in a competitive market that one would expect to command the respect of persons who consider market competition the most efficient mediator of distributive wealth. Many carriers have been driven out in successive trade contractions, but it remains true that no one owns enough tonnage to control prices, thus approximating technically perfect competition in the economic definition.

The industry has, as mentioned, expanded flexibly to upward swings of demand, indicating that it attracts adequate capital. Since 1970, a date of some political importance, it has added 87 new units of 6.6 million tons, including 6 now under construction, growing from 7.5 million tons in 1970 to a peak of 11 million tons in 1981. Following the severe scrappage of these last years, the fleet is now about 9 million tons, averaging about 10 years in age. But at a recent date, domestic tankers still represented nearly 50 percent by number of the entire active merchant fleet of the

United States, including all types in all trades, and nearly 60 percent by carrying capacity, 8.3 million tons against 14.7 million total American tonnage in all trades. This fleet of coastwise tankers, built without Government money, and the product solely of the commercial market, therefore represents by far the largest single constituent of the American merchant marine.

It is by no means certain that its role and station are understood either by the public or in the executive department that has acquired the responsibility of administering the Merchant Marine Act. A study such as has been proposed will no doubt enable all better to comprehend the nature and we think the importance of this sector.

What is required in the meantime is a standstill in executive action that would irrevocably change the conditions of the trade before Congress reaches its own conclusions and proposes its own remedies. We therefore ask that the authorization bill incorporate a prohibition against promulgation and effectuation of any rule or order that would purport to grant permanent entry of subsidized tankers into coastwise trade upon repayment of construction subsidy, this prohibition to operate until a date that allows congressional action in light of the completed study.

Pending such action, the interim proposal we have had in mind would take account of any special shortages of tonnage that might in the meantime develop. Its theme is that while Congress considers a permanent solution, no irreversible change shall be made, but that during this process of consideration, temporary entry shall be open to subsidized tankers on a liberalized if-needed, as-needed basis.

Since a modification of existing law is required to accomplish this purpose, I have attached for the committee's consideration a form of legislative language that may be suitable.

The existing form of section 506 of the act allows the Secretary of Transportation to grant temporary transfer from subsidized foreign trade for periods not exceeding 6 months in any year when she determines the transfer is necessary to carry out the purposes of the act and upon repayment of the subsidy in proportion. At present, the Maritime Administrator has by rule limited the grant of transfer to the Valdez-Panama tanker trade, and essentially to VLCC's and has conditioned such grant on the unavailability for the voyage of suitable coastwise tonnage, which he defines as at least 100,000 tons. Under the rule, he acts on brief published notice, 5 working days, a record compiled by informal adjudicatory process in the form of written comment only, and a short explanation of reasons.

The amendment proposed would temporarily expand the Secretary's powers under section 506 as follows:

During the statutory period, the Secretary would be empowered upon the expiration of an existing 6-month consent to consent to domestic operation for further consecutive terms not exceeding 6 months each upon finding, following proper hearing of interested parties along the same lines as exists now, with respect to each such period, that the application relates to a tanker; that the consent is necessary or appropriate to carry out the purposes and policy of the act; that temporary requirements for additional tonnage exist in the coastwise trade; and that grant of consent will not dislocate normal employment in the trade of existing or prospective new coastwise tonnage.

The amendment would be effective during the period expiring December 31, 1988, which is a rough guess of about the time necessary for a congressional study and action. It is obviously subject to adjustment.

I may add these expianatory observations. The Secretary's findings must be made after proper hearing of interested parties, which the Administrator's present rule defines as the owners or bareboat charterers as to applicants, and Jones Act competitors as to intervenors. This does not mean a hearing on the record in the technical APA sense, but it does require a fair opportunity for parties to be heard in writing or orally, and a decision responding to important contentions and explaining the Secretary's reasons for action consistent with the statute. A separate hearing would be required for each extension for a further 6 months' period or part thereof. This system has worked effectively responding to the rapid movement of the shipping business.

The amendment is limited to tankers because all known requirements for additional coastwise tonnage have been limited to that type, and indeed, to VLCC's. Tonnage of other types and sizes has at no time in recent years been in short supply in any coastwise trade, liquid or otherwise, and will for the foreseeable future be in a state of substantial surplus in all domestic trades.

The requirement of the present statute that any transfer be found necessary to carry out the purposes of the act is carried over to the amendment with an additional clarification of the standard. The statutory purposes, as section 101 expounds them for the domestic trade, encompass promoting and maintaining a private fleet sufficient to carry all our domestic waterborne commerce. This sets up a standard of physical adequacy for that purpose, and the Administrator's present rule applies it in administering section 506 by making the inquiry simply whether defined suitable tonnage is available to make the voyage.

The amendment adds a clarifying standard. Up to now, the problem has concerned subsidsized VLCC's which the Administrator has found to be the class of tonnage in short supply, and they are to have the benefit of the amendment when actually needed for the long voyage between Valdez and Panama. However, entry of the entire VLCC fleet would flood that trade and force the displacement of all smaller tonnage, including ships over 100,000 tons, to the west coast, in turn displacing much tonnage already serving that trade, and causing destruction of another major sector of American tanker tonnage.

The amendment makes clear that the purpose of subsidsized entry is not to force or to allow permanent changes in existing patterns of operation, but to fill out temporary shortages of service in such existing patterns. Meeting long term demand should be reserved to new construction within the Jones Act.

During the effective period of the amendment, no vessel built with construction subsidy is to be allowed permanent entry. The reason for this prohibition is that all requirements for additional coastwise tonnage, which so far have been limited to VLCC's, can be met by the tonnage which is to receive the benefits of the amendment. The standards for temporary admission and the definite expiry date of the amendment will give opportunity for any Jones Act construction of larger tonnage, such as Exxon has recently begun, and such as the continuing threat of wholesale entry by subsidized tonnage has undoubtedly discouraged.

The transition from severe overtonnage to a somewhat better balance reached by scrapping approximately 25 percent of the domestic fleet should not be jeopardized by that threat. During the three-year period, Congress can evaluate the state of the fleet in relation to national policy objectives and make any long range dispositions it may then consider appropriate.

I may repeat that the principle of this proposal is that while Congress deliberates there shall be no irreversible action, but that in the meantime, temporary entry shall be available if and as needed.

[The attachment referred to follows:]

Amend the second sentence of § 506, 46 U.S.C. § 1156, as follows:

The Secretary may consent in writing to the temporary transfer of such vessel to service other than the service covered by such agreement for periods not exceeding six months in any year, whenever the Secretary, *after proper hearing of interested parties*, may determine that such transfer is necessary or appropriate to carry out the purposes of this chapter: *Provided that until December 31, 1988, in the case of tankers the Secretary may grant such consent after such hearing for further consecutive periods not exceeding six months each upon such determination based on a consideration of temporary requirements for additional tonnage that will not dislocate normal employment of existing or prospective new coastwise tonnage, and Provided further that until that date no vessel built with construction-differential subsidy shall be granted permanent entry to the domestic trade.* Such consent shall be conditioned upon the agreement by the owner to pay to the Secretary, upon such terms and conditions as he may prescribe, an amount which bears the same proportion to the construction-differential subsidy paid by the Secretary as such temporary period bears to the entire economic life of the vessel. No operating-differential subsidy shall be paid for the operation of such vessel for such temporary period.

Senator STEVENS. Mr. Klausner, I think you misunderstood my comments of last week. Even if this payback takes place and those tankers enter the trade, they are still Jones Act tankers. One-fifth of all of the petroleum that is being consumed now in the United States comes from land that is owned by my State, and that oil can only be moved on Jones Act tankers. The price of moving that oil is substantially higher than any other oil in the world, and I disagree with your statement where you say that the building of this fleet is solely the product of the commercial market. Building that fleet is solely the product of the Jones Act applied to one State, and to oil owned by that one State.

Under the amendment you suggest, the hearing requirement alone would mean that no CDS payback would take place before 1988. I can tell you right now your amendment is unacceptable to me, will be unacceptable to my State, and I am certain will be unacceptable to the Secretary of Transportation.

You wish to hold up CDS payback while we review the Jones Act, but as I said in the beginning, the tankers which would payback are already Jones Act qualified. By definition, we are talking about the possible entry into this market of Jones Act qualified tankers.

Mr. KLAUSNER. Senator, let me reply going back to the beginning of your statement. This fleet which was built for the Alaska trade, was built within the Jones Act but in response, within the Jones Act, to the demand from Alaska. It was therefore a market factor exclusively. The ships were not built with government money.

Now, the Jones Act is only related——

Senator STEVENS. One eighth of it is money that came from my State. We own that oil, we get one-eighth royalty, the payment for those tankers came, to the extent that they exceeded the cost of tankers in the world market, from my State.

Mr. KLAUSNER. Which, however, was recovered no doubt in the purchase price of the oil.

Senator STEVENS. No, it is not. We are destination priced and back-priced. We have the lowest wellhead price for oil in the country today, if not the world. So that is not so. We absorb the cost of that transportation as a deduction from the wellhead price, and that is precisely why the subject is being raised again and again. As the price of oil falls, so does the value of Alaskan oil.

Mr. KLAUSNER. And so does the price of shipping. The prices in the Alaska prices, the freight rates in the Alaska trade have dropped by about 40 percent in the last 2 years. If there is the incentive provided by the Jones Act, you get ships built. It is when ships are built that you get competitive pricing. That is precisely what has happened in the whole history of even the Alaska trade. You never would have had those ships built if it had not been for the Jones Act. You have got a whole new fleet——

Senator STEVENS. I do not disagree with that.

Mr. KLAUSNER. Yes.

Senator STEVENS. We would have used the tankers that were available in world supply that were surplus at the time.

Mr. KLAUSNER. Well, I suppose, Senator, I would only call to your attention a consideration that you yourself have from time to time uttered in my presence. The reason for the Jones Act historically is a question of defense: If you feel that that defense consideration has evaporated, your best alternative is not to introduce this new sector of high cost shipping, but to open the trade to world shipping. You will then in that case get the world rate, the most competitive shipping in the world. You will get that at all times.

I dare say, however, that Alaska——

Senator STEVENS. What you do not seem to comprehend is that the country has had the advantage of Alaskan oil during a period of very high pricing for world oil rates. As the price of oil comes down on the world market, the Alaskan oil faces the prospect now of not only being shut down, but the exploration probably will come to an end because of the fact that the price has fallen so much.

We are no longer in a market where oil is priced in the high $30s per barrel as it was for a while. The world price of oil is coming down. It is now almost to the point where it is lower than the Alaskan oil price at Valdez. You are right, the cost of shipping has come down, but that is because the value of the oil has come down. Many of those were ad valorem prices, as you and I know. So it is not something that has resulted from competition. It came from the world oil price. As the price came down, the shipping rates came down. But as a practical matter, the problem the country has to face is whether or not it is going to price Alaskan oil out of the market by virtue of continued high shipping costs.

It costs more now to ship a barrel of oil from the North Slope to the Gulf than it does to buy oil in some markets of the world. And so long as that continues, the disincentive to the exploration and development of Alaska's resources will be apparent.

Mr. **Klausner**. I have not observed that this exceptionally pessimistic statement is one that either you yourself or other authorities in Alaska have uttered publicly. I think that this is not only an unduly excessively—an unduly pessimistic statement, but it does not weigh the factors that are actually here at work.

American shipping has been a defined cost of movement all the time. As a matter of fact, I am a little taken aback by the strength of your utterance, your pronouncement, because just recently there was held in Alaska a conference, a shipping conference at which shippers, including the president of a shippers' association, said that Alaska at present was enjoying a buyer's market for shipping services, that there was so much excess space that the rates were coming down quite drastically and altogether suitably to the interests of the State of Alaska.

I am therefore astonished to hear from you that at a time when these rates certainly in the tanking industry, have led to the scrapping of a quarter of the fleet, that you should find those rates out of reach.

Senator Stevens: I just compared them to worldwide rates. Also you should be aware that the shipper comments you referred to concerned liner cargo going north, not the southbound oil trade.

Mr. **Klausner**. You can always compare them with the worldwide rates, sir, and will you have any doubt that at any given time a nonconference rate, a rate made in open competition will always be higher for an American carrier than for a foreign carrier? Without subsidies and without conference arrangements, will they not always be higher?

Senator **Stevens**. I do not think necessarily so.

I call your attention to the fact that the people of Alaska recently voted an instruction to the Governor of Alaska to come to Congress to seek a repeal of the Jones Act because of its impact on Alaska's development.

Because of its geographic location, Alaska is limited solely to American built transportation in order to export its bulk commodities. Elsewhere you can move bulk commodities to your ships in foreign built trucks, in foreign built airplanes, in foreign built railroad cars, but in terms of Alaska, we move everything in and out of Alaska in American built ships, and that is a serious restriction in our economic development.

We now have the highest unemployment rate in the country, and we have the greatest decline in State revenues in the country. If you think I am speaking in terms of an isolated opinion, I can assure you that the people of Alaska think that the Jones Act is strangling the possibility of future economic development in their State, particularly in the oil and gas industry.

Lets get back to your proposed amendment. As I read it, your amendment would increase the number of tankers that could protest the entry of CDS tankers into domestic service.

Mr. **Klausner**. They are all the same. There is no change in that whatever, sir.

Senator **Stevens**. It is our understanding that your language would allow tankers under 100,000 deadweight tons to protest; tankers which are now precluded from protest because the Secretary of Transportation has determined, by regulation, that such tankers are not suitable for that trade.

Mr. **Klausner**. That is not involved in this at all, sir. This in no way affects that.

Senator **Stevens**. That is not the way we read it. In any event, your amendment would cause delay by insertng into section 506 an undefined hearing requirement which is not now part of the statute.

Mr. **Klausner**. That is also not the case. The hearings are there right now, and they would simply continue on the same very rapid basis. They are not—there seems to be some real misapprehension on this score.

The way the system works——

Senator **Stevens**. No misapprehension. I tell you now I will oppose your amendment, I will oppose anything that will prevent the Secretary from promulgating her rule on May 15.

Mr. **Klausner**. Well, I hear that with very great regret, and I hear it with particular regret because it seems to me to be founded on mistaken premises.

If your opinion, Senator, is based upon the information of the sort that has just been repeated to you, if there have been representations to you of the sort that you have just mentioned, all of which are without foundation, and all of which are mistaken, I trust that you will keep your mind open long enough to hear the correct statement of what this bill would do.

Senator **Stevens**. I am told that your amendment would put a hearing requirement into section 506 and the hearing would in all probability under the Administrative Procedures Act take longer than the 6-months waiver period.

Mr. **Klausner**. That is absolutely incorrect. There is not the slightest foundation for that statement. Exactly the same procedure that is followed now by the administrator would be followed then, and that is that he puts a notice in the Federal Register when he gets an application to put a ship into the trade; he gives 5 working days in which to make any comment one wants in writing, and he decides within 2 working days thereafter.

There is absolutely no change in that procedure.

Senator **Stevens**. How long does the hearing take?

Mr. **Klausner**. That is the hearing. You write him a letter. You say I have got a ship or I have not got a ship.

Senator **Stevens**. Who protests?

Mr. **Klausner**. The people who protest are the owners of ships who say that their ship is available for the voyage.

Senator **Stevens**. Is that the extent of what is required currently under existing law? Obviousy it is not.

Mr. **Klausner**. Yes, it is required under existing law.

Senator **Stevens**. Well, then, why do you need the amendment?

Mr. **Klausner**. Because this gives a further concession. The law at present allows only a 6 months a year charter or entry. We are allowing successive 6 months permissions. We are making a further concession. Instead of being held to 6 months in a year, one can come in and ask for further entry consecutively.

I am astonished that there should be this degree of misapprehension, I take it, in your staff, Senator.

Senator **Stevens**. You can be astonished all you want. I rely on the information I get, and I do not take lightly your attitude about my staff.

Currently, do the small tankers have this right to protest?

Mr. **Klausner**. Not under the present rule.

Senator **Stevens**. They would under your amendment.

Mr. **Klausner**. That is a matter solely within the authority of the administrator.

Senator **Stevens**. But this does change the law, Mr. Klausner.

Mr. **Klausner**. No, it does not in any respect change the law except to allow an additional 6 months.

Senator **Stevens**. Again I tell you, it is unacceptable to me. I will oppose it on the floor, and I would not permit such a bill to pass if it is within my power to prevent.

Senator Inouye.

Senator **Inouye**. The chairman has spoken, and I am certain the chairman's view will be adhered to in this subcommittee.

I have said this in the past, that as far as the CDS payback is concerned, I will not object to the Department of Transportation adopting this rule, but keeping in mind that the Congress can, if it so wishes, after the administrative and judicial appeals have run their course, study the final result, and if we find it unacceptable, make changes at that time.

But the administrative and judicial processes are available, and when they have run their course, I think we can move ahead.

Senator **Stevens**. We are in agreement on that. You cannot really get to the point of having Congress decide what to do until you start the appeal process and see where the courts are going to go.

Senator **Inouye**. So therefore, what the chairman says I believe expresses the will of the subcommittee.

Mr. **Klausner**. I hear that pronouncement with great regret.

I thank the committee.

Senator **Stevens**. Thank you very much, Mr. Klausner.

Our next witness is Mr. Mills, representing Apex Marine, American Petrofina, Moore-McCormack and SOHIO.

Good morning.

STATEMENT OF THOMAS L. MILLS, COUNSEL, REPRESENTING APEX MARINE, AMERICAN PETROFINA, MOORE-McCORMACK RESOURCES, INC., SOHIO, AND ARCO

Mr. **Mills**. Good morning, Mr. Chairman and Senator. I am Thomas Mills. You have my statement, Mr. Chairman, on behalf of Moore-McCormack and Apex Resources, I ask that it be considered for the record.

In addition, I appear here and am authorized to state on behalf of Atlantic Richfield, the Standard Oil Co. of Ohio, and American Petrofina, that they are opposed to any legislation which would in agree personally, and a number of my clients would. But let's see, what has this done for defense, Mr. Chairman?

Again a reference to the coastwise product trade. The coastwise product trade is indeed in tough shape insofar as American shipping. Why did that occur, Mr. Chairman? Mr. Chairman, it occurred because the rates were so high that alternate forms of transportation were developed, pipelines, rail, other forms.

Now, that trade is permanently lost, or much of it is permanently lost to ships, and it is lost because the rates were kept abnormally, artificially high, high with Government interference, Government restrictions. Had that not occurred, with a little more competition, a little lower rates, that trade would not have been lost.

So it is shortsighted to suspect, I think, that increased competition is bad for defense because, I think, the future of the merchant marine lies in increased competition, lower rates, more efficiency.

Second, Mr. Chairman, I think there is a great analogy between the direct subsidy system of the Merchant Marine Act and the indirect subsidy of the Jones Act. They are both subsidy systems, there is no question about that. When Congress considered, however, the direct subsidy system, sir, they had—it came with strings. You are either going to have open market or you are going to have regulation. If you are going to regulate, you are going to regulate.

What they required of the subsidized operators under the Merchant Marine Act was, one, to get rid of their foreign flag affiliations. If the Government of the United States was going to subsidize them, they did not want that money going into foreign ships employing foreign crews. Second, they wanted them to agree to renew their ships. They had to have replacement obligations so that we always had the most modern and the best ships.

Now, there are no such strictures in the Jones Act, and what has happened on the Jones Act, Mr. Chairman, is these awful old tankers which have kept the rates high are proof that there hasn't been any modernization or not nearly the kind of modernization that has been required. And so it has been counterproductive in that regard.

Second, the enormous profits—and I say enormous profits—that have been generated over the last several years have not led to increased American new building. In fact, if you look very carefully at the companies represented by the American Maritime Association, you will see that the major participants in the Alaskan oil trade have far, far bigger foreign flag fleets, and those foreign flag fleets, Mr. Chairman, do not have American crews. There is not anything happening for the U.S. defense there. That is U.S. dollars propped up by U.S. regulation which are going over there, building foreign ships, employing foreign crews. I fail to see how that helps defense at all.

Senator STEVENS. I am inclined to agree with you on that.

Senator Inouye.

We appreciate your statement, and your full statement will be placed in the record, Mr. Mills.

I hope that you and your clients do not misunderstand us. We are reserving the right to make a decision in the final analysis after this process has been commenced.

Mr. MILLS. We do not misunderstand. We not only understand it, Mr. Chairman, but we agree with it.

SENATOR STEVENS. Thank you very much.

[The statement follows:]

STATEMENT OF THOMAS L. MILLS

Mr. Chairman, I am Thomas L. Mills of Kominers, Fort, Schlefer & Boyer, and I am appearing today on behalf of Moore McCormack Bulk Transport, Inc. and Apex Marine Corp. Moore McCormack Bulk Transport owns and operates three 38,000 dwt tankers which were constructed with the aid of CDS. Apex Marine Corp. is the managing agent for subsidized vessels operated by Aeron Marine Shipping Company, American Shipping, Inc., Aquarius Marine Company, Aries Marine Shipping Company, and Atlas Marine Company. All of these companies own and operate 90,000 dwt tankers except Aries Marine Shipping Company which operates two OBO's of 80,000 dwt. All of these vessels were constructed with the aid of CDS. Captain Leo V. Berger is the principal owner of these companies and they are collectively known as the "Berger Group."

During the past two years the Berger Group has testified on several occasions before the House Subcommittee on Merchant Marine in support of the rule proposed by the Department of Transportation to permit admission to the domestic trade of fully qualified Jones Act tankers through repayment of CDS. Today, however, is the first occasion on which we are able to present the arguments in favor of CDS repayment to this committee--and we are grateful for that opportunity.

THE BENEFIT TO THE TREASURY AND THE PUBLIC

The benefits to the Treasury which will be derived from the repayment of subsidy are enormous. If the Berger subsidized companies are permitted to repay CDS on their six remaining vessels, the government will recover nearly $120 million in CDS and interest. Termination of their ODS contracts would save the government an additional $300 million over the remaining lives of the contracts.[1] If all of the owners of the 15 remaining CDS-built vessels of greater than 80,000 dwt repay CDS with interest and Keystone Corp. cancels its ODS contract on its two CDS vessels, the government will receive or save approximately one billion dollars. If the twelve 35,000 dwt tankers elect to repay CDS and cancel the ODS contracts covering 10 of the vessels the government will receive or save an additional $500 million dollars.

Payback of CDS will have the further benefit of decreasing the cost of transporting Alaskan crude oil to the Gulf and East Coast via Panama through the use of these large, optimum size vessels to the benefit of American consumers who pay the freight. The reduction in transportation costs also increases Federal and Alaska tax revenue by increasing the wellhead price of Alaskan oil. For every dollar increase in the wellhead price, the Federal government receives approximately sixty cents in windfall profit and income taxes and the State of Alaska receives twenty-eight cents, or an increase of between $50 and $100 million yearly in revenue for Alaska alone. Since the tax rates on Alaskan crude oil are much higher than the normal effective corporate tax rate, the increase in Federal tax revenue from payback will clearly exceed any loss in revenue from reduced income taxes on the profits of the current operators in the trade.

The reduction in transportation costs for shipping Alaskan crude oil to the East Coast and the increases in both the Federal government's windfall profit tax revenue and Alaska's tax and royalty revenue which will result from CDS repayment, will provide benefits which are nearly equivalent to the cost savings which would result from exporting the oil to Alaska—and we will keep our oil for our citizens' use.

THE JONES ACT FLEET RECEIVES GREATER SUBSIDY THAN OUR SHIPS

The owners of the present Jones Act fleet contend that it would be unfair to permit the subsidy-built and operated tankers to invade their trade and displace their "unsubsidized" ships. The notion that the present Jones Act fleet is unsubsidized is a fabrication. Both fleets are subsidized—the only difference is that their subsidy is much greater than ours. Their subsidy comes from three sources: the protection of the Jones Act, the cargo preference laws, and the operating subsidy they were paid in the Russian grain trade.

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[1] The cost therefore to the Berger subsidized companies of entering the domestic trade would be $400 million.

The Jones Act.—When the Jones Act fleet operates in the domestic trade, the differential in capital and operating costs between these vessels and foreign vessels is indirectly, but fully, subsidized by the consumers of the United States through the payment of higher transportation charges than foreign vessels would demand in the trade if they were not barred by the Jones Act. The only differences between this Jones Act subsidy and our direct subsidy are that ours is much less than theirs, and ours is conditioned upon replacement obligations and an outright ban on affiliations with foreign-flag operations. For example, the ODS and CDS paid in respect of the Berger Group ships amounts to about $3.50/dwt. The protected rates in the domestic trade for identical ships yields a subsidy of about $9.00/dwt.

The preference trade.—Their vessels receive further government subsidy for carrying preference cargo in the foreign trade of the United States. The cargo preference statutes reserve certain portions of government-impelled cargo to United States vessels at fair and reasonable rates. This results in rates for the U.S. portion of preference cargoes substantially higher than rates for the foreign portion. The difference—or "premium"—is paid by the government. That premium is a subsidy.

The Russian grain trade.—Finally, their vessels received a direct operating subsidy—paid under the Merchant Marine Act of 1936—of substantial proportions in the Russian grain trade for most of the decade of the seventies. The owners of the so-called "unsubsidized" fleet—the very owners who oppose the entry of our subsidized ships into the coastwise trade—actively lobbied for the adoption of this subsidy program. The subsidy they received in the Russian grain trade was far greater than the subsidy paid under the standard operating-differential subsidy contract for bulk vessels. The subsidy in the Soviet grain trade covered fuel, subsistence of officers and crew, stores and supplies, other vessel expenses, depreciation and interest costs directly attributable to the subsidized vessel (the equivalent of the payment of both CDS and a subsidy on interest on vessel indebtedness for the period the vessel operated in the Soviet grain trade). Between fiscal year 1973 and the end of fiscal year 1982, U.S.-flag operators earned $102,000,000 of subsidy for operations in the Soviet grain trade. Virtually all of that subsidy was paid to independent tanker operators who now oppose the repayment rule. Indeed, some of the most vociferous opponents of CDS repayment received large amounts of subsidy under that program, e.g., Overseas Shipholding Group, Inc.—$30,000,000, Ogden Corporation—$13,600,000, Cove Maritime Companies, Inc.—$6,000,000, and American Trading Transportation Co.—$2,200,000. Many of the domestic tankers which subsequently carried Alaskan crude oil would not have survived the hard times of the early 1970's (prior to the opening of the Alaskan pipeline) without the government subsidies they received under the Soviet grain program and the cargo preference laws.

In summary, Mr. Chairman, our opponents' contention that their Jones Act fleet is "unsubsidized" is a pure fabrication. Their fleet is far more heavily subsidized than the fleet which would avail itself of the proposed rule.

ODS COST THE BERGER GROUP ITS FOREIGN-FLAG FLEET; THEIR SUBSIDY SUPPORTS THEIR FOREIGN-FLAG FLEET

Because the Berger Group subsidy is a direct subsidy subject to Title VI of the Act and the AMA's is an indirect subsidy not subject to that Title, the Berger Group was forced to liquidate its foreign-flag holdings while the AMA members are permitted to maintain, even expand, their foreign-flag holdings. When the Merchant Marine Act of 1970 became law, Captain Berger controlled a substantial foreign-flag fleet of nearly 20 vessels. As required by section 804 of the Act, 46 U.S.C. § 1222, he liquidated his interest in this fleet in order to qualify for subsidy. Several other large independent tanker operators—including many of the present owners of the Jones Act fleet—were not willing to dispose of their foreign-flag fleet as Captain Berger did. Indeed, many of these operators have greatly expanded their foreign-flag fleets since 1970, while continuing to enjoy the benefits of subsidy of the Jones Act, of the cargo preference laws, and (until recently) of the Russian grain trade.

The Jones Act protects domestic operations from foreign competition in order to promote a strong and modern American Merchant Marine. The cost of doing so—the subsidy—is borne by the U.S. consumers who pay the higher resulting freight rates. The siphoning of profits earned in the Jones Act trade to build and support foreign-flag vessels is a flagrant violation of that policy. If a subsidized operator were to use his direct subsidy for that end he would violate the law.

THE STATUTORY PROMISE OF PARITY HAS BEEN BROKEN

The statutory promise of the 1970 Act of parity of cost with our foreign-flag competitors has been illusory. Relying on the promise, the Berger subsidized companies contracted for the construction of nine bulk vessels, the first two of which were 82,000 dwt OBO's, and the last seven of which were 89,700 dwt tankers, all built at the National Steel and Shipbuilding shipyard is San Diego.[2] The vessels were constructed with steam turbine engines. Both Title V of the Act and the Maritime Administration's regulations under Title XI require that all materials and components used in subsidized vessels be of United States origin. Similarly, Moore McCormack contracted for its three handy-size tankers which were constructed at the same yard with similar steam turbine engines. At that time, no American-manufactured slow speed diesel engine was available. Also at that time, all U.S.-flag vessels were constructed with steam turbine engines because the higher maintenance and repair costs associated with diesel-powered vessels more than offset the savings which would be derived from their greater fuel efficiency.

After the oil embargo of 1973, when the cost of fuel began to rise, the economics of bulk vessel operation switched dramatically in favor of diesel-powered ships. The cost of bunkers rose from $2.00 a barrel to between $18 and $22 a barrel. Accordingly, the cost of operating a steam-powered U.S.-flag vessel is today much greater than that of the diesel-powered foreign-flag vessels operated by our competition. Indeed, the amount of the fuel consumption cost differential is greater than the total operating subsidy payable under the subsidy contract, which means that the operating subsidy—which was intended to make U.S. vessels' cost competitive with their foreign competition—covers less than half the differential. The statutory promise of cost parity of the 1970 Act has been broken and our vessels cannot compete with foreign vessels.

Our opponents argue that allowing CDS repayment would change the rules in midstream. The rules, however, have already been changed in midstream. The Berger companies spent huge amounts of money to build a U.S.-foreign trading fleet and liquidated their very substantial foreign-flag fleet on the promise of cost parity. As just discussed, despite the promise, cost parity has not been achieved. If the cost parity needed to compete in the foreign trade will not be achieved, then fairness dictates that the Berger companies and other similarly situated operators be allowed to repay CDS and enter the domestic trade.

Moreover, even foreign-flag tankers cannot operate at a profit in today's world market. The tremendous supply of tankers built in the 1970's, the decrease in the amount of petroleum moving because of conservation and the oil glut, and the shorter distances which oil is transported because of the development of oil production in Alaska, Mexico and the North Sea, have all combined to create a long-lasting depression in tanker's rates. Most tankers today are barely covering their operating costs at world rates and are not earning enough to cover the amortization of their long-term debt. None can be chartered in today's world market at rates profitable to their owners. This depression in the world tanker market will, according to the experts, continue for several years.

ADMISSION OF THE CDS BUILT VESSELS WILL NOT DISPLACE ANY MODERN VESSELS IN THE DOMESTIC FLEET

The admission of the CDS vessels into the domestic trade will not displace any modern vessels in that fleet. If the Berger companies repay the unamortized portion of the CDS on their vessels with interest, they will have the highest capital cost of any vessel in the crude oil fleet below 100,000 dwt, and any tanker, product or crude, over 55,000 dst. The remaining original Title XI indebtedness and borrowings to finance the CDS payback will total approximately $30,000,000 on each vessel; annual debt service will approximate $4,200,000 per vessel. With that debt load the vessels will require a charter rate of nearly $11 per ton to break even. The other vessels in the domestic fleet between 60,000 and 100,000 dwt can earn a profit at rates substantially below $11/ton because of their much lower capital cost and debt service requirements. These vessels can be fixed if the owners are willing to accept a reasonable return (instead of the exorbitant profits they have been earning in the last few years) before any of the subsidized vessels which have paid back subsidy are fixed. Since none of the subsidized vessel owners will repay subsidy unless they are sure that the rates in the Alaskan trade will permit them to service the substantial additional debt incurred for the payback, the existing fleet is assured of a reasonable return.

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[2] The Berger Group currently operates six vessels since two of the tankers were recently acquired by the Navy to the converted into hospital ships and earlier a tanker was lost at sea.

Not all of our opponents are operators of only old, inefficient tonnage. Some of the operators of tankers below 55,000 dwt which have been constructed in the last five years at a high capital cost have alleged that they will not be able to obtain profitable employment in the Alaskan trade if the subsidized vessels are permitted into the trade because of their smaller size and higher capital costs. Their argument should be disregarded. Since these vessels are having difficulty finding employment now—when none of the CDS vessels are in the trade—CDS repayment can hardly be the cause of their unemployment. The reason these vessels are not employed in the Alaskan trade is that they are not suitable for the carriage of crude oil; they are product carriers, and should only be utilized in the carriage of product in the Gulf Coast to Atlantic Coast trade or on the Pacific Coast. That trade has been depresed because of the recent drawing down of reserves due to the oil glut. That situation should improve dramatically in 1986, when the total capacity of U.S.-flag product carriers will be diminished drastically by the loss of capacity to segregated ballast or scrapping of ships which do not comply with the requirements of the Port and Tanker Safety Act. Indeed at that time, there should be room for Moore McCormack's handy-size tankers in the product trade if they elect to repay their subsidy.

Since admission of the subsidized crude carriers into the Jones Act trade will not force any of the crude carriers of 55,000 dwt or greater out of the trade, the strenuous opposition to payback by the independent vessel operators with newer, larger vessels cannot be based upon fear of unemployment. Rather it is based on the hope of protecting the huge profits they have been earning—profits which are essential to keep their vast foreign-flag fleets afloat in the current depressed international tanker market.

Due to a temporary aberration in the domestic trade, in the past two years some of the larger vessels employed on the Alaskan oil movement on the West Cost have been laid up for various periods. During the past two years, more Alaskan crude oil has been consumed on the West Coast and consequently less of the oil has moved through Panama to the East Coast with a corresponding reduction in demand for the very large ships to transport crude oil to Panama. In the future, as both Alaskan and California crude oil production increase, greater and greater quantities of Alaskan crude oil will have to be moved through Panama to the Gulf and East Coast of the United States. It is our firm belief that even after CDS payback, every crude carrier of over 100,000 dwt will be employed in that movement, while every crude carrier of over 55,000 dwt will be employed on either the East or West Coast movements of that oil.

THE EFFECT OF CDS REPAYMENT ON TITLE XI GUARANTEED DEBT

It has been asserted in various comments filed in response to the notice of proposed rulemaking that hundreds of millions of dollars of debt guaranteed by the government under Title XI of the Merchant Marine Act, 1936, will be placed in jeopardy as a result of the repayment of CDS. Thus, Ogden Corporation asserted that this exposure is "conservatively $888 million and could be as high as $1.562 billion." These assertions are not only erroneous, they are ridiculous.

First, many of the vessels stated to be "at risk" by opponents of the rule are under long-term charters to oil companies for the carriage of proprietary Alaskan crude oil. For example, six of the vessels with the largest amount of Title XI guaranteed debt outstanding (total exposure $331 million) are chartered for their economic lives to Sohio.

Second, another group of vessels, the Hess integrated tug/barge units (total exposure $343 million), which are usually included in these calculations, are being utilized by Hess primarily in the carriage of proprietary petroleum products from the Virgin Islands to the United States which is not a Jones Act trade. Indeed, these vessels are operated and managed by the Berger Group.

On the other hand, the Title XI guaranteed debt outstanding on the subsidized fleet is more than $250 million. Given the current and expected future of the foreign trade, if these vessels are not admitted to the domestic trade, a substantial portion of that $250 million in Title XI debt will be truly at risk.

RECENT DEVELOPMENTS SUPPORT THE RULE

Mr. Chairman, I would now like to briefly discuss various recent developments which strongly support the adoption of the proposed rule.

First, last year Atlantic Richfield Company, one of the key producers of Alaskan crude oil, stated that there will be no decline in the production of crude oil in

Alaska through the decade of the 1990's. The development of such new Alaskan fields as Kuparuk, Milne, Seal Island and Point Thompson, and the increased use of water injection and gas reinjection to enhance secondary and tertiary production from existing fields support the revised Arco estimate. In short, Mr. Chairman, even if all of the eligible vessels elect to repay CDS, there will be ample crude oil flowing from Alaska for the next fifteen years to employ these vessels without diminishing the employment opportunities of all suitable existing vessels in the domestic trade. It is our firm belief that every tanker owner whose vessels are larger than 55,000 dwt will be able to find employment for his vessels at rates which permit a reasonable return on investment even after CDS repayment.

Second, Mr. Michael Klebanoff, the President of the AMA recently testified before a House subcommittee in opposition to CDS repayment. He stated that in the past three years 65 tankers have been deleted from the U.S.-flag fleet. He neglected to inform the Committee, however, that nearly all of those vessels were over 20 years of age at the time of their deletion. Since the opening of the pipeline across Panama in 1982, most of these old, inefficient vessels—whose only utility in the Alaskan trade was their ability to transit the Panama Canal—have not carried Alaskan crude oil. Finally, these old vessels are inherently unsafe for American crews, present grave danger to our environment, and have no rational economic basis for continuing to trade. The continued exclusion of the modern subsidized fleet from participating in the domestic trade has created an incentive for continuing to operate these obsolete vessels long after their economic lives have ended. They should be scrapped.

Some in the military have argued that these smaller, over-age tankers may be useful in time of national emergency, despite their age. If that is so, then the government should adopt a program to purchase these otherwise obsolete vessels at scrap value and place them in the National Defense Reserve Fleet. It would only take a small part of the money which the government would recoup from the repayment of construction-differential subsidy to find such a program. Maritime policy should not be utilized for the preservation of "rust buckets" in the name of national defense.

In fact, it is highly questionable whether these vessels have the defense utility the military claims. Despite the spending of hundreds of billions of dollars on new weapons each year and hundreds of millions of dollars for the purchase of fleet oilers, the Department of Defense has not, to our knowledge, seen fit to find the funds to purchase a single one of these vessels (obtainable for little more than their scrap value) when they have become available. In the last three years 65 of these vessels have been scrapped while the military has stood idly by.

Third, it should be noted that despite Mr. Klebanoff's protests this past year in support of the domestic fleet, less than two years ago his company, OMI Corp., purchased the foreign-built 136,000 dwt tanker *Arkas* (since renamed the *Ogden Columbia*) which was constructed in a foreign shipyard and subsequently repaired in the United States under the Wrecked Vessels Act. That vessel enjoys a far greater competitive advantage than a CDS-built ship by virtue of its low cost foreign building with only some repairs required in the U.S. Unlike the CDS-built ship, entry into the domestic trade is not conditioned on payment of an amount equal to the foreign advantage to place it back on a parity with U.S.-built ships.

OMI Corp's reflagging of the *Ogden Columbia* for utilization in the domestic trade exposes the hypocrisy of its protests on behalf of the domestic fleet. While that ship is equivalent in tonnage to five of the small tankers which it complains are currently laid up, OMI had no compunction about availing itself of its advantage. Ironically, OMI Corp. and others similarly situated acknowledge the advantage but boldly assert that they are entitled to the benefit because the Wrecked Vessels Act is the law. CDS repayment is also the law, as confirmed by unanimous decision of the Supreme Court. It is not the proponents of CDS repayment who are "changing the rules." It is the opponents of the rule who are here asking this Committee to change the law, for their own selfish benefit, to the detriment of the Merchant Marine and the American public.

Fourth, an argument has been made that the Maritime Administration can alleviate any shortages of tanker capacities in the Alaskan trade through grant of six-month waivers to subsidized ships for participation in that trade. Not only has this program proven to be totally inadequate, it amounts, in our view, to one of the strongest arguments for CDS repayment. Under the Maritime Administration's regulation, no six-month waiver can be granted unless every single vessel in the fleet of more than 100,000 dwt is already fixed. Last year the Maritime Administration forced the removal of 750,000 dwt of subsidized tankers from the Alaskan trade to blackmail the shippers into hiring smaller vessels on short-term charters at exorbitant rates. Indeed, during 1984, Marad only granted two six month waivers and discriminatorily denied a waiver application by a third vessel. The shippers need the CDS ships, and under Marad's procedures they have no choice but to meet the outrageous demands of the owners of these "old maids" which are blocking the CDS ships from participating in the trade. The events involved in the termination of January of last year of six-month domestic operating waivers for 750,000 dwt tons of subsidized VLCC's are illustrative. The waivers were terminated because two ships, including the *Odgen Columbia*, were "unemployed." The evidence showed that the *Odgen Columbia* was unemployed because OMI Corp. had attempted to charter it at the stupefying rate of $17.50 per dwt per month. Ultimately, under pressure of the District Court attack, the *Odgen Columbia* was chartered for three years at a rate ranging from $11.00 to $12.00 per dwt per month, still sufficient to earn profits of several million dollars a year from that ship alone for OMI Corp., and a rate which it would continue to be able to charge after entry of the CDS-built ships into the trade. And the *Odgen Columbia*, Mr. Chairman, is a foreign-built ship qualified under the Wrecked Vessels Statute.

Similarly, another leading opponent of subsidy repayment last year chartered its foreign-built Wreck Act vessel for six months at $15.25 per dwt per month. At a charter rate which is $4/dwt higher (or $5,700,000 on an annual basis) than the *Odgen Columbia*, its profit margin can only be characterized as outrageous.

Our opponents have portrayed the subsidized fleet as being a "second-class" American merchant marine. In reality our vessels, just as theirs, were built in United States shipyards, are operated by United States citizens, and are every bit as eligible to participate in coastwise movements under the provisions of the Jones Act.

In summary, it should be noted that the benefits to the United States which will accrue from the repayment of subsidy are enormous. If all of the operators of subsidized tankers elect to repay subsidy and enter the domestic trade, the government will receive or save (in cancelled obligations for operating subsidy) 1.5 billion dollars. The cost of transporting Alaskan crude oil will be reduced by a third to the benefit of U.S. consumers who pay the freight. The United States will receive increased revenue of several hundred million dollars a year from the windfall profits tax on Alaskan oil and the State of Alaska will receive 100 million dollars a year in increased tax revenue. These sums would help reduce the current budgetary deficits.

Mr. Chairman, the alternatives are clear. We can either continue the present system which produces enormous profits for a few operators and artificially extends the useful life of ships that have long since outlasted their economic utility, or we can enhance our merchant marine while at the same time providing substantial benefits for the consumers and taxpayers of our country.

Senator **Stevens**. Our next witness is Vice Adm. Robert Scarborough, Coast Guard, U.S. Coast Guard, retired, representing the U.S. Merchant Marine Academy Alumni Association.

STATEMENT OF VICE ADM. ROBERT H. SCARBOROUGH, USCG RETIRED, REPRESENTING THE U.S. MERCHANT MARINE ACADEMY ALUMNI ASSOCIATION

Admiral **Scarborough**. Mr. Chairman, Senator Inouye, I am Vice Adm. Robert H. Scarborough, U.S. Coast Guard, retired, speaking on behalf of the U.S. Merchant Marine Academy Alumni Association.

Our organization represents the approximately 17,000 persons who have been graduated from the Academy during its nearly one-half century of existence. Today these graduates are employed at virtually every level of every segment of the maritime industry, both afloat and ashore, both in management and labor, both ship operations and construction. They are in our Government, both as military and civilians. Others are making significant contributions to a broad spectrum of the rest of our society.

I am a 1944 graduate who has enjoyed a very rewarding career, many aspects of which are quite typical of other alumni. I have served in the U.S. Merchant Marine, U.S. Navy, and U.S. Coast Guard as a seagoing officer. I periodically renew my unlimited ocean master mariner's license, originally earned decades ago. After 4 years as Vice Commandant, I retired in 1982 from a 33-year career in the Coast Guard, which included command both ashore and afloat. Following retirement from the military, I was executive director of the Navy League of the United States for 2 years. Like virtually all graduates of Kings Point, I am proud of the school and most appreciative of the thorough preparation it provided for my efforts in support of the Nation's sea power for more than 40 years.

We believe that the framers of the Merchant Marine Act of 1936 have proven to be very wise and uncommonly farsighted. They established as national policy that U.S. Merchant Marine officers were to be educated and highly trained at all times. They voiced special concern for the total sea power requirements of our Nation in time of war, directing close cooperation between the Navy and Merchant Marine. Toward these ends, they established the Federal Academy at Kings Point.

The alumni are grateful for the understanding of this committee and the Congress through the years which has resulted in the unique national asset which Kings Point represents. We solicit your continuing support.

We appreciate the opportunity to share with you today our views on the Maritime Administration appropriation authority request for fiscal year 1986. We applaud the efforts of the Secretary of Transportation and the Maritime Administrator, as well as those of their respective staffs in these controversial and budgetarily competitive times, to strengthen the U.S.-flag merchant marine. Generally we concur with, and urge your support for, the administration's maritime training proposals. However, there is one specific item with which we must respectfully disagree, and another about which we must express concern.

We disagree with and ask you to reject the proposed additional 5-percent cut in the size of the next entering class at the Academy. Responding to a recommendation of the Grace Commission and reflecting upon a shortage of seagoing job opportunities, the Maritime Administrator ordered a 10-percent reduction in the size of the 1983 entering class. He mandated an additional 10-percent reduction in the size of the 1984 entering class. Like good sailors, the Academy administration cooperatively and cheerfully, but I suspect with great trepidation, implemented these orders. The result is that the Academy will have approximately 20 percent fewer midshipmen appointments in all future entering classes than it did 2 years ago.

Over a 4-year period, this reduction will result in a total of 280 fewer students entering the Academy. Allowing for the anticipated 25- to 30-percent attrition, the actual impact of the 20-percent admissions reduction in terms of average size of the student body would most likely be 200 midshipmen. There will be 150 fewer on campus and 50 fewer at sea at any given time.

These reductions have had, and will continue to have a profound effect on the Academy program. The Maritime Administrator has stated that he expects no cuts beyond the additional 5-percent cut proposed this year. We are most grateful for his commitment to watch carefully for possible deleterious effects from the reductions taken. Nevertheless, cutting too far or too fast is a real and present danger which could have serious consequences for the quality of the professional and academic programs.

Further cutbacks can jeopardize the institution's optimum student-faculty ratio and force the withdrawal of valuable elective courses which require minimum numbers of students enrolled in them; can produce an underutilization of facilities, affecting the cost efficiency of the Academy program; can entail a reduction in the training force which would limit the diversity of the curriculum, and foster a fatally narrow trade school approach. It can curtail many extracurricular activities which help to produce well-rounded graduates; and could ultimately even injure the status of the institution as an accredited college.

Kings Point has become recognized as the international standard for maritime education. Many foreign countries have gone there for guidance when seeking to improve their own maritime training and safety efforts. This premier institution is seen by many as a potential University of the Sea. It would be a tragic loss if this bright shining beacon of our educational system were unintentionally relegated to a minor or unbecoming role.

Reductions made now would not complete their initial effects until 1989. There currently is widespread increasing concern for the national security mission of the American merchant marine. The administration and Congress are committed to restoring our commercial shipping and military sealift capabilities. Currently a large number of our licensed merchant mariners are reaching retirement age. We could very well find ourselves in the next decade with fewer than needed U.S. Merchant Marine Academy graduates and no quick method of producing them.

Even during the most threatening days of World War II, this country never risked licensing a deck officer with less than 16 months concentrated experience and specialized training. Just in the first war year alone, we lost half of our effective ships' officers to enemy action. Many Kings Pointers made the supreme sacrifice while still cadets afloat, 142 to be exact, an unparalleled situation in the armed forces. This is to say nothing of hundreds of others who swam off of ships that were sunk from under them or survived enemy attacks while still cadets.

With tremendous expansion of wartime shipping demands, officer shortages were acute. Even with the relatively unsophisticated technical requirements of that day, merchant marine officers could not be produced overnight.

The cyclical nature of the industry has resulted in humps in licensed officer age distribution with middle age being the mean for deck officers sailing today. Although difficult to prove short of an actual wartime test, we have doubts about the actual availability, experience, and currency of many licensed officers involved in counts which point to an oversupply. For example, there even seems to be a likelihood of double counting when the various general agents give assurance to the Maritime Administration that they can reactivate all the ships of the Ready Reserve fleet when required to do so as scheduled, simultaneously, with personnel having the specific experience needed. Or, assuming that we can indeed rely upon the hulls constituting our "effective controlled fleet", can we really count upon sustained manning by any but U.S. citizens when the country needs to send them out in "harm's way?" These are only initial and incremental concerns as we look upon sealift requirements for an extended global conflict. The result would be a tenfold or more sudden expansion of the numbers of licensed billets afloat.

We believe the 1936 act was especially perceptive in its recognition of the need for education in addition to narrower professional training. The American standard of living dictates that we compete with our brains rather than with brawn. Wherever the U.S. merchant marine has done so, it has remained competitive. While still in transition to a high technology, capital intensive endeavor, it has come a long way since 1936. Ships 'officers today must be much more sophisticated from both mechanical and managerial standpoints, as we get more productive ships with fewer unlicensed crew members.

The Academy has worked very hard to stay current and relevant through this time of great change, and has succeeded. It remains capable of providing the Nation with a nucleus of mariners well prepared to meet the demands of the maritime activities of today and adaptable to tomorrow's changes. The Academy's strict admission system assures that the brightest and most motivated young Americans, geographically representative of the entire Nation, receive the university level education and training, including approximately 1 year "on the job" at sea on working ships. This allows them not only to "hit the deck running" on their first postgraduate maritime jobs, but to compete successfully for the highest rungs of several different career ladders thereafter.

Experience shows that these young people carry away from the Academy the qualities of self-discipline, responsibility, leadership and maturity which make them good citizens and predict success in their chosen seapower careers. Our country will always need them and more like them.

In addition to a mariner's license and accredited degree in engineering or transportation, all Kings Point graduates receive Naval Reserve commissions. Kings Point produces more Naval Reserve officers than any other single institution, making it second only to the U.S. Naval Academy as a source of naval officers. Further, on short notice, it can accelerate its output to meet emergency needs as was done in the Vietnam era. More significantly, with existing facilities, the enrollment can be doubled whenever ordered to meet national requirements.

Many Kings Pointers enter extended active duty either immediately upon graduation or at a later time, with some integrating for full regular naval careers. Future graduates will remain active in the Naval Reserve for a minimum of 6 years. Graduates enter the other armed forces as well, with an increasing number going into the U.S. Marine Corps in recent years. In recognition of this, the Commandant of the Marine Corps took a personal initiative recently to have two Marines added to the Merchant Marine Academy's staff to assist in training the regiment.

In recent years, it has been most gratifying to see the Navy give national emergency requirements for merchant ships some degree of priority. Not only has it expanded the available shipping under its own direct control, but has elevated sealift to co-equal status with the two previously longstanding navy missions of sea control and power projection. The broad U.S. Merchant Marine Academy curriculum is ideal for providing the Navy and other armed forces officers with the educational background and skills to staff billets in this expanding area, either as active military officers, licensed mariners afloat, or as essential civil servants ashore.

Thus, I believe that we should be much more concerned for a potential long-term shortage rather than for an excess of merchant marine officers to fill presently available afloat billets. This is coupled with the firm belief that the unique program at the Federal Academy produces a quality product that will always be in short supply. Nevertheless, we all are concerned for the current dearth in licensed entry level and general seagoing employment opportunities. But, more than four out of five of the newly licensed ships' officers seeking berths at sea come from sources other than Kings Point. For the past decade, the Academy output has remained rather constant, varying between 200 and 250 per year. During this same period, in the face of generally declining shipboard employment opportunities, the output from all other sources, including the State maritime schools, has approximately doubled.

The other area to which the Kings Point alumni wish to invite your close scrutiny is the availability of funds for general operations and maintenance at the Academy. The cumulative effects of economies in recent years, coupled with inflation and an aging plant, are putting a severe strain in some areas. The cuts in the Academy's modernization program funding likewise are counterproductive. The physical plant is in excess of 40 years old. Plumbing, heating and electrical services in many buildings require updating. Facilities that were adequate for students under wartime constraints four decades ago do not meet current needs or standards.

Last year Congress cut Academy modernization funds without prejudice to help finance other programs. The intent was for these funds to be restored this year. This year the administration proposes to cut these same funds once again, setting back modernization plans while the facilities continue to deteriorate.

In summary, Mr. Chairman, I am sure that you agree that the U.S. Merchant Marine Academy has proved itself to be an efficient, effective, and unique resource, truly focused on national rather than regional needs, both in the national defense and commercial transportation arenas. The Academy's educational program deserves strong continuing support by the Federal taxpayer.

We ask that the proposed additional 5-percent cut in enrollment be rejected outright. We further ask that cognizance be taken of the adverse effects of recent funding at levels lower than those authorized and needed for the Merchant Marine Academy's operating expenses.

I thank you very much.

Senator STEVENS. Thank you very much, Admiral.

I hope that we can arrange to go with you to Kings Point and look into the maintenance problem before we mark up this bill. I do not want us to neglect the maintenance of the Academy. These are tight years for all of us, but there is no reason to let the installation deteriorate.

Admiral SCARBOROUGH. You have a standing invitation, sir, along with your staff, and I am certain I can help you arrange a visit at any time that it is convenient.

Senator STEVENS. Well, as the head of the Alumni Association,. we will notify you before we go.

Admiral SCARBOROUGH. Yes, sir.

Senator STEVENS. Thank you very much.

Senator Inouye.

Senator INOUYE. Mr. Chairman, I thank you.

Admiral, a few days ago a person very knowledgeable about the fleet activities made the following statement: "Mr. Chairman, 20 years ago our fleet was nearly double in size, with an even greater number of jobs. Yet today, MarAd plans to graduate more Merchant Marine Academy graduates, 230, than there were in 1965, 219."

What percentage of last year's graduating class had seagoing jobs or fleet related jobs?

Admiral SCARBOROUGH. Well, as you know, Senator Inouye, the Maritime Training and Education Act requires the graduates to serve in certain categories or capacities, and I have some figures here that are broken down in accordance with the categories that are prescribed in that act.

In the worst year 1983, 19.8 percent obtained employment afloat: 49.4 percent were in maritime related jobs ashore; 17.7 percent went in the Navy or Coast Guard; and 13 percent in other categories. The figures for the years preceding 1983, show there were 33 percent in 1982, 74 percent in 1981, and 83 percent in 1980 who went directly afloat to ships. In 1984 it was back up to 25 percent. So it is varying in that range right now. But the important thing is to note that USMMA graduates are finding suitable employment, according to these snapshot surveys taken, I believe, 3 to 5 months after graduation date. Better than 90 percent at that time have found employment in one of the four categories that are set forth in the Maritime Training and Education Act.

Senator INOUYE. Thank you very much, Admiral.

Thank you, Mr. Chairman.

Admiral SCARBOROUGH. And in regard to your question, Senator Inouye, if I could expand a little bit, the witness that you are talking about is one that you and I both know. I have known him fairly well for many, many years, and he has mellowed quite a bit since he has entered his sixth and seventh decades. He is a man of great knowledge and ability, well versed in the maritime field. However, it was interesting that he selected partial statistics, for the years mentioned.

The Kings Point output has remained very constant since 1949. The actual number of graduates has varied a little bit, but basically it has been the same.

During these years numbers of license applicants, including those from schools sponsored by this gentleman's organization, have increased considerably. In fairness to him, though, they have dropped off in the very last year, and I understand they are going to drop even more next year. But only about 16 to 17 percent of all these new licensed officers are coming from Kings Point.

Senator INOUYE. Thank you very much,

Senator STEVENS. Thank you very much, Admiral.

Our next witness is Rear Admiral Miller, president of the State University of New York Maritime College. He is accompanied by Admiral Aylmer, the Massachusetts Maritime Academy, and Admiral Swarztrauber, superintendent of the Maine Maritime Academy.

STATEMENT OF REAR ADM. F.H. MILLER, USN (RETIRED), PRESIDENT, STATE UNIVERSITY OF NEW YORK MARITIME COLLEGE, ACCOMPANIED BY REAR ADM. JOHN F. AYLMER, USMS, PRESIDENT, MASSACHUSETTS MARITIME ACADEMY; AND REAR ADM. S.A. SWARZTRAUBER, USN (RETIRED), SUPERINTENDENT, MAINE MARITIME ACADEMY

Admiral MILLER. Before testifying, Senator Stevens, let me say that all of us—and I have Admiral Swarztrauber on my right from Maine and Admiral Aylmer from Massachusetts—but all of us from the State maritime academies, both in regard to appropriations and authorization want to thank you for your assistance in the past. You have been one of our champions.

I will be speaking on behalf of the State maritime academies and colleges of New York, Maine, Massachusetts, Texas, California, and the Great Lakes region. We have submitted a joint statement for the record. This statement represents our combined views. But before we do, I would like to just show you how we are doing, if I could just take a minute.

This runs more or less in line, Senator, with what the Federal Academy just told you relative to employment. Actually, 1982—and I did not put 1982 on here because a couple of the schools did not have good placement figures, but if you will note in 1983, 34 percent of our graduates were afloat, and it has moved up now to 41.5. And of course, on the other side, unemployment, which was higher—in fact, it was very high in 1982—has now improved. And now we are down to 14.2 percent.

But I must underscore this figure here under other. It also includes graduate school and unable to contact. My secretary runs placement, and I can tell you—I think some of the reasons that they are unable to be contacted is that they are at sea.

But if you total up the numbers in 1984 for the average State maritime academies, 75 percent are at sea, and then we add another 10.6 percent in nonmaritime related ashore. We come out to about 85 percent employment, 75 percent which is in the seagoing trades upon graduation or shortly thereafter.

Senator STEVENS. How do you get 75 percent out of that schedule?

Admiral MILLER. 41, 21.7 and 12 in the Navy.

Senator STEVENS. I see. You mean they are maritime related?

Admiral MILLER. Yes, sir.

I should also point out that most of these graduates are either in the Merchant Marine Reserve or, in the case of Maine and New York, we have NROTC. So a large number of these go straight into the Navy from the NROTC units.

The other statistic that Admiral Scarborough alluded to was the age of the merchant marine officer today. I got these figures from MarAd. I got these figures from MarAd in 1983. I have not moved them to the right, but if you note that the large bulk of officers sailing today in U.S. flag is over here close to retirement, in fact, I venture to say that they have moved over here even further to the right. Also, you note the recent academy graduates responsible for this pinnacle on the left. There is a big valley between them that is going to have to be filled, and I feel that we are ready to produce those officers and in fact are producing them already.

In fact—and I did not put another series of graphs on here because it would become too cluttered—for the previous several years it starts out like this, getting bigger and bigger, and it is starting to expand now, and I venture to say that within the next year or so this is going to move over even further, as this moves over into retirement. But that is how we are doing.

As I noted, our academies produce about 700 graduates a year, 10 to 12 percent are going on active duty in the Navy or other services, and a vast majority are commissioned in the Naval Reserve. We feel we are cost effectively training a cadre of officers who can be mobilized in time of emergency to man our merchant marine. This is important today, as I noted, as the average age of our merchant officer in our U.S. flag fleet nears retirement.

Along with the Federal Academy, we are the recruiting base and the training base for our merchant marine officer cadre. We recruit and we train those coming into our shipping community.

We have two major issues today, Senator, that we would like to discuss, related to our training ships: the lack of fuel funding in the Maritime Administration's budget, and MarAd's lack of a training ship replacement plan.

We appreciate your recognition of fuel funding in S. 679 which was also contained, I might point out, in House bill H.R. 1157. We are grateful and deeply appreciate your support and action over the past several years on the fuel funding issue, but in view of the introduction of S. 679 and also in view of the press of time, I will address the other issue. That issue is MarAd's lack of a training ship replacement plan.

You will recall because of an unfortunate fire, Massachusetts maritime ship was replaced with a new, more state of the art vessels. Our other academies presently support old ships. For example, California's was built in 1939. Texas' was built in 1944; Maine's and New York's in 1952. MarAd is scrapping younger ships.

Parts are hard to find. We have stripped the World War II Reserve fleet.

Senator STEVENS. Why don't we swap your vessels for newer ships from the Reserve fleet? Has that ever been explored?

Admiral MILLER. Sir, I would like to do something with the ship that we have now and get a new one, which is what I am working toward.

Senator STEVENS. I know, but if they are scrapping younger ships, the least we could do is swap them and let them scrap your older vessels.

Is there any kind of information about where these vessels are? Does the Navy have any vessels laid up that you could use?

In the current budget circumstance, to get enough money to buy six ships—will be difficult. Once we start, we are going to deal with all of them. You know, the universities as well as I do. If you get a new one, Maine is going to have one, Massachusetts, and all of them are going to have new ones, and I do not see that we can get that kind of money in the next 3 years.

Admiral **Miller**. MarAd was supposed to look at this, if you recall from the appropriation budget last year, and they had 6 months to come up with a newer one. They could not find one. I venture to say that—well, I know the ones in the Reserve fleet are older than ours, are dc power, and—in fact, we have been stripping them. As far as other ships on the world market, Admiral Aylmer tried very hard to get a foreign vessel and see if it could be reflagged, but the costs were just exorbitant. The Navy's vessels are a different type of vessel, and I do not believe there are any right now that would be or could be made available.

It really is an indication of the type of ships we have today, and there are not many on the shelf. The ships that of course we are looking at for follow-on to the Massachusetts maritime ship are cargo/passenger, so the passenger side of it can be expanded. We are talking taking cadets in numbers from 500 to 700 to 800, including staff and faculty, on a ship. So it must be expanded.

And we are looking at the cheapest way to go, and we recognize that dollars are of great importance, so that we looking at a ship that can be expanded, one that already has the built-in living, berthing, and messing that can be expanded upon. And there are few ships today that are available.

This just brings me to my next point, that we are concerned as to where do we find them—if MarAd says the ships will last 5 years—and they have said they will last 5 years for the last several years—where do we find 4 suitable ships all available 5 years from now? Will money be available to replace them in bloc?

If not, replacement necessarily will have to be stretched out. If one is purchased every other year commencing 5 years from now, it would be up to 15 years from now before the last one is replaced.

MarAd has been funding repairs on our ships to meet the minimum safety and regulatory requirements, and this is a holding action. There has been little or no improvement in their training capability or in their habitability. Each year these ships get more and more obsolete as training platforms. They never were converted to training ships. Classrooms are makeshift and spaces are cramped.

Our students are paying, in addition to the States, for training on equipment they will never see again. Engineers are operating dc-powered equipment and boiler combustion control equipment that no longer exists in the world. Deck and navigation equipment are also limited by dc power. Last year the Congress appropriated $8.5 million to continue a training ship replacement plan. This was to be used to purchase a new ship for New York if, as I noted earlier, MarAd could not come up with a better one, a follow-on to the Massachusetts ship.

Now MarAd wants to defer the money and of course continue with the ships-will-last-5-more-years policy.

It is requested that this money not be deferred, and that MarAd be directed to provide a replacement plan.

I would like to read a few quotes from several distinguished individuals, Senator. One, a letter to you by the 10 Senators from the States supporting deepwater academies.

Senator STEVENS. I read it. They talked to me.

Admiral MILLER. I would like to just mention——

Senator STEVENS. They also voted for a budget that restricts new initiatives, so you will have to go talk with them again.

Admiral MILLER. Yes sir, we will.

Senator STEVENS. People that signed that letter are supporting the budget that restricts this subcommittee.

Admiral MILLER. May I just read what Representative Biaggi had to say on the full House floor September 28, 1982? It is just two short paragraphs.

He says, first I would like to highlight the fact that the condition of the federally provided training ships that are being used to train prospective merchant marine and Naval Reserve officers at the State maritime academies is close to a national disgrace. They are old, devoid of spare parts, full of antiquated training equipment and fuel inefficient. These antiquated vessels are simply not capable of providing state-of-the-art training.

Then last, but not least of my quotes, I would like to read from testimony from the Maritime Administrator on the March 2, 1983 where he says "Realistically, as a mariner, I have been going to sea for over half a century. They ought to be replaced."

Senator STEVENS. I am compelled to ask you, I have been supportive of the program, but in view of the situation, why is this not a private sector obligation partially?

Admiral MILLER. It is a private sector obligation partially.

Senator STEVENS. Did they ever provide you a ship, the private sector?

Admiral MILLER. The way the Merchant Marine Education and Training Act is structured, the Federal Government provides the ship in turn for what the State gives as well. Only about 10 to 15 percent of what the funding put into the Merchant Marine Reserve Training Program and the whole Merchant Marine Act is federally funded. The rest is either funded by the students or funded by the State.

Senator STEVENS. I understand that, but the Government doesn't contribute airplanes for the training of airline pilots so why should it provide vessels to your schools? I have seen the chart of the lifetime income of the people that you train. It exceeds that of an airline pilot.

Somewhere along the line we ought to start asking where is the private sector contribution to this program?

Admiral MILLER. Well, sir, I believe with the amounts that the States put in——

Senator STEVENS. That is still Government.

Admiral MILLER. The students also pay.

Senator STEVENS. The students are getting subsidized education. I understand they pay about $4,000 per year.

Admiral MILLER. Our students pay $5,100 a year to go through our school. It varies at other schools.

Admiral SWARZTRAUBER. Mine is $6,700.

Admiral AYLMER. $6,000 in Massachusetts.

Senator STEVENS. The figure I saw was $4,000, $4,500. Maybe it has changed.

We will do something about providing the fuel your ships need. We will see what we can do about replacement ships. But I will tell you, that six ships will be difficult to fund. I am correct? Is it not six?

Admiral MILLER. We are talking 4 ships, and we are asking for a structured program, not all at once, Senator, 1 now and maybe 2 years from now another one, and then maybe 2 years from now another one, with conversion in the years in between.

Senator STEVENS. I hear about vessels being laid up all over the world. This may be a good time to reach out and look for them. Have you tried that? Do you have your eye on any?

Are they foreign built or U.S. built?

Admiral AYLMER. Senator, you are deserving of an update with respect to the singular vessel that has been purchased as a replacement vessel.

For the record, I am Admiral Aylmer, Massachusetts Maritime Academy. The *Santa Mercedes*, which your committee, Senator, assisted in appropriating the moneys for, was purchased. I hesitate to call it a new ship because it in fact is a 22-year-old vessel. However, the *Santa Mercedes* has been now renamed the *Patriot State*. It has been reactivated on the west coast and presently is being converted in the gulf coast. Prior to its acquisition, activation and conversion efforts, I undertook a nationwide search, and of course, a worldwide search for a diesel vessel which, as Admiral Miller alluded to earlier, was totally out of the realm of possibility with respect to projected reflagging costs.

Getting to the point, the vessel that we hope to acquire at our campus this next summer will be, as Admiral Shear depicted, a very austere vessel. Interestingly enough, a sensitive point that you made earlier Senator, with respect to private industry contributions to the effort, we have worked very hard and have secured a host of testing equipment, machine shop equipment, diesel generators and a number of other items that could go on the *Patriot State*. However, the *Patriot State* will not be able to accommodate those private sector donated items because of the austere fashion in which it is being converted. Presently there is not enough conversion money to put classrooms on the vessel. Ironically, there is only one navigation chart table on the entire vessel.

The point of the matter is that another $1 million will be needed to make it a suitable vessel.

Senator STEVENS. What could you build a new one for in Korea?

Admiral AYLMER. Depending on size, I would estimate probably something in the order of $80 million to $100 million brand new.

Admiral MILLER. And you bought yours for $4.5 million?

Admiral AYLMER. This vessel was purchased for $4.5 million.

Senator STEVENS. What is it going to cost to refurbish it?

Admiral AYLMER. Presently, it is difficult to get the figures, and MarAd could supply them to you, but I would estimate something in the order of $15 million has been devoted to this conversion, and activation project.

You will recall, Senator, that initially $10 million was appropriated. I came back last year urging that another $5 million be appropriated. Because of the austere fashion in which the budget was put together last year, that additional $5 million was opposed by MarAd, but to your credit, this committee appropriated it, and if it had not been appropriated, this vessel never would have been able to be secured and put into shape for our utilization next year. And yet, the conversion project is still short by I think about $1 million.

I do not have any objections to sailing an austere ship, but certainly I think it would be more serviceable if another $1 million were added to the project, and I would be remiss if I did not now request that verbally as a supplement to our collective written testimony, Senator.

Senator **Stevens**. Well, the problem is that you will be back year after year to get another $1 million to keep that vessel going. It is going to be 22 years old when you start using it.

Admiral **Aylmer**. I am requesting $1 million today Senator, so hopefully I will not have to be back here in subsequent years. I think the *Patriot State* can be an ideal vessel. It is far from ideal now. I am not even looking for an optimum vessel, but I do think to sail a school ship without even one classroom space fitted out on the whole vessel is rather absurd.

I would also hasten to add, if I could, Senator, that the Commonwealth of Massachusetts and Massachusetts Maritime Academy has this last week, after a reassessment of our situation in the yard, put forth a proposal that we utilize upwards of $200,000 of academy trust moneys that I should be using for something else but I am now intent on devoting this to the vessel.

So I wanted to point out that there is a cooperative venture that has surfaced here, and I think that that should be credited.

Senator **Stevens**. All right.

Admiral Swarztrauber, do you have any other comments?

Admiral **Swarztrauber**. Yes, please, Senator. We have never thought in terms of new ships. We realize the economic problems.

Senator **Stevens**. I do not know why you do not. Most of the people you train are going to be serving on modern foreign built vessels.

Admiral **Swarztrauber**. Yes, sir, and we know the price of new ships is between $100 million and $150 million. And you pointed out that it is a buyer's market right now with the ships being laid up like they have been.

We have got our eyes on used ships. The used ships we are thinking about do have ac electrical systems. The dc systems that we have now are just impossible to get parts for. We cannot operate proper laundries, proper navigation equipment with them. At least we would have a proper electrical system with these newer used ships.

We are thinking of approximately $20 million per school for four schools.

Senator **Stevens**. I am told Sea-Land is paying about $30 million for container ships overseas, and most of your people are going to be serving on vessels like that. Why should we be training them on vessels that have no relationship to the vessels they are going to serve on?

Admiral **Aylmer**. Senator, that is ostensibly a cargo vessel, of course, carrying probably 20 people to man the vessel. As Admiral Miller has pointed out, we sail upwards of 700 cadets and officers, all of whom have to be accomodated in concert with Coast Guard rules and regulations, berthed. They have to have habitable spaces, sanitary facilities, messing facilities, galleys, and all of the trappings that are associated with education, namely, electronic labs, navigation labs, and a host of other items aboard. It is not a bare cargo vessel.

Senator **Stevens**. We will direct MarAd to come up with a plan for replacement of these vessels. And we will see what happens then.

I must tell you, though, that a replacement plan will have to include a financing plan. I do not see under current budget restraints any possibility of $100 million a year for 4 years.

Admiral **Miller**. $10 million a year, Senator.

Senator **Stevens**. I think that is inadequate. You are operating a program, to put a 22-year-old vessel at work in the university. It just means you will be back here in 4 or 5 years for more money.

Admiral **Miller**. Sir, if I could just elaborate for one minute on what Admiral Swarztrauber said, on vessels that have AC power, we can change the equipment. I am trapped right now with our ship in that there are no laundry parts. I cannot put additional navigation equipment on it. The chill water system does not work. Why? Because it is DC equipment. No one makes it anymore.

But if we go into the 21st century and the laundry breaks down, I can go down to the laundry store, buy more equipment, change the foundations and put new laundry equipment in. I firmly believe that these vessels will take us into the 21st century.

Senator **Stevens**. All right. Very well, gentlemen, we thank you.

I appreciate your courtesy. I did look at the photographs you provided. They do present graphically the rundown condition of the New York training ship.

Thank you very much.

[The statement follows:]

JOINT STATEMENT BY THE PRESIDENTS AND SUPERINTENDENTS OF THE MARITIME ACADEMIES/COLLEGES OF CALIFORNIA, NEW YORK, MAINE, MASSACHUSETTS, THE GREAT LAKES REGION AND TEXAS

The statement is submitted on behalf of the Presidents and Superintendents of the Maritime Colleges and Academies of California, Maine, Massachusetts, The Great Lakes Region, New York and Texas. We wish to address two major issues related to our training ships, namely, continuation of fuel funding and a replacement plan for these obsolete vessels.

For the past several years, as allowed by the Federal Maritime Education and Training Act, the Congress has appropriated funds for fuel to operate our training ships. Two years ago, three million dollars ($3,000,000) was appropriated and last year two million, one hundred thousand dollars ($2,100,000) was appropriated. These fuel funds were in addition to the allocations for students incentive payments of $100. per month and the direct grant of one hundred thousand ($100,000) to each institution.

Despite the Maritime Education and Training Act and the continued sense of the Congress, the Maritime Administration has once again failed to include a request for funds for training ship fuel in their 1986 fiscal year budget submission. We appeal to the Senate again for training ship fuel funds to allow us to operate our ships and train students properly. Recognition of this requirement has been acknowledged by the House Committee on Merchant Marine and Fisheries in House Bill H.R. 1157.

Continuation of this fuel funding is doubly important as the rules governing training of deck officers undergo changes mandated by the International Maritime Organization Standards of Training, Certification and Watchkeeping for Seafarers. The new standards require one year training for deck cadets aboard ship or an acceptable equivalent. Adoption of this convention requires us to expand the training of our deck students at considerable additional cost to each institution. The provision of funds for fuel for the operation of the training ships on their annual cruises eases the burden of these newly mandated requirements without large increases in student fees and excessive increases in State support.

This very small financial support by the Federal Government represents one of the best bargains available to the Government which is so dependent upon the sea for national security and commerce. The very small savings to the Federal Government gained by not funding training ship fuel would impose a severe training hardship on our students, who pay to attend, and the States, and it will reduce the incentives to develop an adequate Merchant Marine Reserve component of the U.S. Naval Reserve.

We submit that the continued existence of our State-supported institutions assure an economical, cost effective method of producing maritime officers. We believe that our students return far more to the economy than they cost and that the survival of the State Academies/Colleges is in the national interest.

We would also like to address the other issue that we noted at the outset—a plan for replacement of obsolete training ships.

The Merchant Marine Act of 1936, as amended in Public Law 96-453, the Maritime Education and Training Act of 1980, authorizes the Federal Government to provide training ships for the State Maritime Academies and, in practice, the Federal Government has done so. In 1983, it was the stated intention of the Maritime Administration to continue to do so. In pursuit of that objective, the Maritime Administration has taken steps to purchase and convert a 1960 passenger-container ship for use by the Massachusetts Maritime Academy. We applaud this progress and appreciate the support of the Committee on this project. The other existing training ships are being maintained with Federal funds. They are:

Golden Bear, California, built in 1939.
Texas Clipper, Texas, built in 1944.
Empire State, New York, built in 1952.
State of Maine, Maine, built in 1952.

These ships do not in any sense represent the commercial fleets currently at sea, let alone the ships being constructed today. Their maintenance is expensive and more difficult each year, and repair parts support is nearly non-existent. Piping and other distributive systems are wasting away. They utilize direct current (DC), not the universal (both on land and sea) altenating current (AC), for electric power. Few ships in the world today are DC powered; fewer companies manufacture equipment designed for DC power.

Our training ships are materially satisfactory but marginal at best, with respect to Coast Guard standards for safety. Their habitability standards are those of 30-40 years ago. Training facilities are makeshift and cramped. It should be noted that our Cadets are asked to endure and, in fact, pay for these standards. These ships are also poor representatives of the United States in international and maritime circles. Most importantly, they make marginal training platforms. It is clear that in some incremental way, they should be replaced over the next several years. Technology is greatly affecting ship design and the equipment installed in ships and yet the Maritime Administration has no plan to bring our training laboratories—our training ships—up to current world standards. It should be noted that many Third World countries are way ahead of our Nation in the modernity of their training ships and equipment.

Our training ships are not now linked in any way to strategic sealift resources and requirements of U.S. defense. The various academies are not, of course, knowledgeable about future U.S. strategic sealift requirements. We are, however, aware that the Defense Department is funding the modernization of the Ready Reserve Fleet (RRF) and its significant expansion over the next four years. We are also aware that in November 1982 the Military Sealift Command conducted an Auxiliary Troopship Study for the Navy which apparently decided that placing the state academy training ships in the RRF was not only feasible but a good idea. Of course, appropriations would be required to place the ships in the proper conditions to be in the RRF. We do not know what the status of troopship study is today.

It would seem that there is potential economy and mutual benefit to be derived from planning to replace the maritime training ships as part of the RRF buildup and incorporate the replacements as a part of the RRF. Either a troopship or modified bulk cargo ship could meet training needs, and surely these types must be a part of the inventory of ships in the RRF. Our ships are routinely maintained by Cadet labor and the States share in the costs of upkeep by funding consumables and maintenace staffs. These ships are strategically located around the Nation and not nested in the Reserve Fleet where they are all vulnerable to attack.

The economies to the Federal Government gained by including replacement training ships in the RRF procurement are obvious, significant and, in our judgment, worthy of pursuit. Additionally, savings would accrue in annual maintenance cost. The academies would see that their training ships were ready assets, and the academies would benefit with more modern training platforms and a certain and timely replacement schedule.

To date the Maritime Administration has no plan with respect to replacement training ships other than continuing to spend money to keep these marginal training platforms in the minimum material condition required to meet Coast Guard standards. This is a holding action. The Maritime Administration's replacement policy is esentially a "Flat Earth Policy." They say the ships will last five more years. At that point it can only be assumed that four ships will all come to the end of their usefulness and fall of the "edge of the earth." With no structured plan, for example, the replacement of one every two years, the State academies are faced with a block shutdown of their main laboratories. Where do we find four suitable ships all available five years from now? Will dollars be available to replace them in block? If not, replacement will be stretched out so that it could be ten years before all ships have been replaced. That is fifteen years from now. Each year these ships get more and more obsolete as training platforms.

Our students are paying for training on equipment they will never see again. For example, engineers are operating DC powered equipment and boiler combustion control equipment that no longer exists in the world. The Maritime Administration is scrapping ships that were constructed after these vessels' keels were laid down.

It is interesting to note that the Maritime Administrator on 2 March 1983 at the Hearing before the House Subcommittee on Merchant Marine stated in testimony that "the training ships ought to be replaced."

We ask that Congress cause the Maritime Administration to develop a replacement plan to resolve the obsolence of our training ships at the earliest possible moment. The lack of a replacement plan was recognized last year by all ten Senators of the States supporting maritime academies in a letter to Senator Stevens. The following is a quote: "The problem was a serious one in 1980, it is now critical. The Administration must take action soon to insure that the state academies can safely and effectively train their cadets at sea. Past experience leads us to believe that MARAD will not seriously develop a satisfactory plan unless directed to do so by the Congress."

Last year in the Fiscal Year 1984 Supplemental Appropriation Act (P.L. 98-396), 8.5 million dollars was appropriated to purchase a new training ship for New York Maritime College, a follow on to the Massachusetts Maritime Academy ship. From this action it is clear that the sense of the Congress is that these ships should be replaced. The Maritime Administration has recently requested that the Congress defer these funds to defray other and unrelated operations and training in 1986. This action confirms that there has been a consistent lack of effort on the part of the Maritime Administration to develop any type of long-range plans to replace the existing, aging and obsolete State training vessels. We strongly urge that this deferment be overriden and that a sister ship to Massachusetts ship, which is available, be purchased. This would continue, not halt, the action that was obviously the sense of the Congress.

We know that you are addressing legislation which will preserve and restore the merchant fleet which is essential for our nation's survival and for continued presence on the high seas. We feel our academies are an integral part of the whole. When ships are needed, officers to man them will also be needed. The generations of officers trained to operate the ships in the years when the merchant fleet was much larger are nearing retirement. The young men and women now in our schools will be available for years to come.

The Maritime Education Act of 1980 established obligations for our students and graduates in order to assure a supply of Merchant Marine Reserve Officers who will be trained and available immediately for service as needed in the merchant marine or navy in response to an emergency. The manning of our Ready Reserve and national defense reserve fleet ships, and even the so-called effective controlled (U.S. owned foreign flag) ships in response to national emergencies can be most effectively accomplished using existing Merchant Marine Reserve Officers if these ships are to operate with the U.S. Navy.

The issue that we have described today are of extreme importance to our continued well being. The State Maritime Academies and Colleges at mimimal Federal cost have produced and continue to train outstanding officers for service in the Merchant Marine, the U.S. Navy and Coast Guard, NOAA and other service-related organizations. We have appreciated your past support and trust that we may continue to receive your confidence and support in the future.

The United States needs a strong and competitive Merchant Marine. We play a large role in attracting, recruiting, educating and training the young men and women of our Nation for a career at sea. We must remain viable if our Merchant Marine is to prosper. The issue we have raised today impact directly on our viability. We trust you will give our requests and views your favorable consideration.

[The following information was subsequently received for the record:]

State University of New York,
Maritime College,
Bronx, NY, April 2, 1985.

Hon. Daniel K. Inouye,
U.S. Senator, Hart Senate Office Building, Washington, DC.

Dear Senator Inouye: On behalf of all the Presidents and Superintendents of the State Maritime Academies and Colleges, I would like to thank you for the privilege of testifying before the Senate Sub Committee on Merchant Marine. We appreciated the opportunity to discuss the two major issues related to our training ships, that of fuel funding and the Maritime Administration's lack of a training ship replacement plan.

As I am sure you recall, an issue was raised during testimony on 21 March about employment of our graduates as well as those from the U.S. Merchant Marine Academy (Kings Point). I regret that due to the press of time, I was unable to testify that day and to be able to address that issue immediately. However, at the continuation of testimony on 29 March I did.

Despite the allegations, our graduates do get jobs in the Maritime Industry and, in fact, do better than graduates from most specialized colleges.

The average placement figures taken 5 to 6 months after graduation in 1983 and 1984 are as follows. I hasten to point out Kings Point's figures are comparable.

STATE MARITIME ACADEMY EMPLOYMENT

[Percent]

	Afloat	Maritime related ashore	Nonmaritime related ashore	Navy/Coast Guard/NOAA	Other [1]
1983	34.0	19.0	10.0	10	27.0
1984	41.5	21.7	10.6	12	14.2

[1] Grad School/Unemployed/Unable to contact.

These figures equate to 75 percent involved in the Maritime Industry or Armed Services. I am sure it is even higher as those we were unable to contact may be at sea.

Another related issue is the projected requirement for jobs. I have enclosed two graphs which depict that the average Merchant Officer sailing today is nearing retirement. The 1985 average age is 58. As you can see, a big valley exists behind the "average hump" which is and will be filled in by academy graduates.

I hope this sheds a different light on the employment issue. While things are not rosy in the cyclic industry, they are getting better. Our comparable unemployment figure in 1982 was 51.7 percent. As you can see from the above, it was 14.2 percent in 1984.

Again, thank you for the privilege of testifying. If there are any questions I have left unanswered be they related to employment, training ship fuel funding or a training ship replacement plan, please do not hestiate to contact me. You and your staff have an open invitation to visit all of our State Maritime Academies and Colleges anytime. We would be delighted to show you these great National assets.

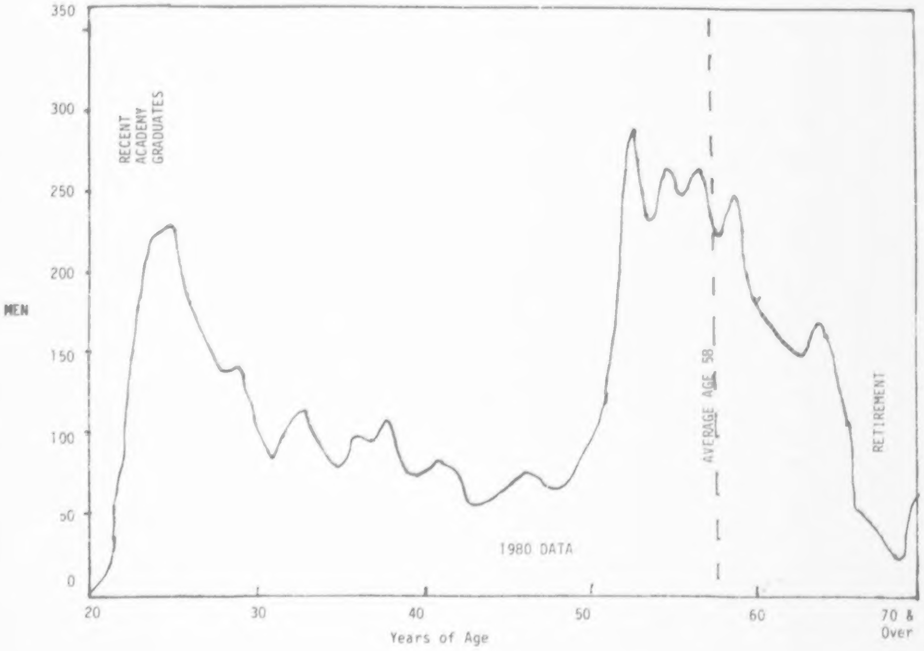
Sincerely,

F.H. Miller,
Rear Admiral, USN (Ret.).

Enclosures.

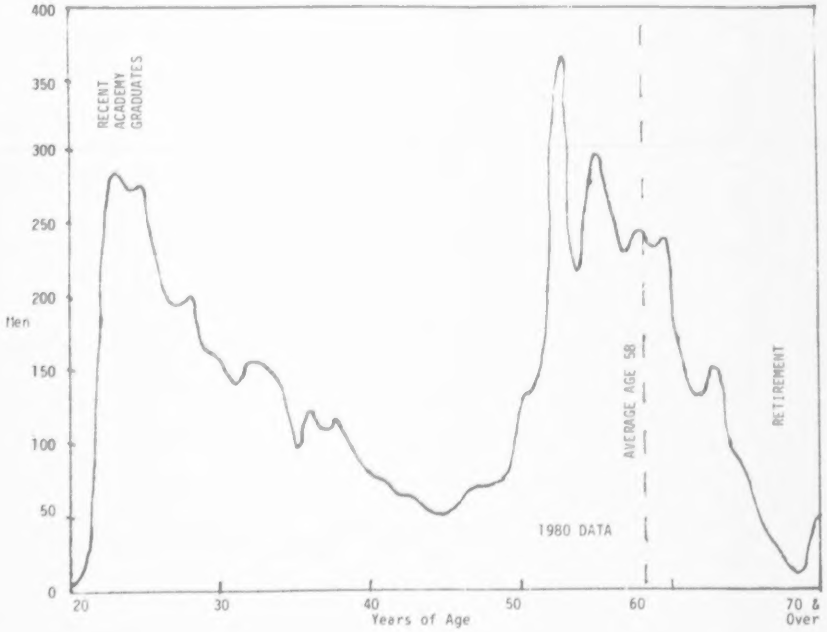
STATISTICS DEVELOPED BY MARAD -
OFFICE OF MARITIME LABOR AND TRAINING -
NOVEMBER 1983

DECK (OCEANS) OFFICERS



STATISTICS DEVELOPED BY MARAD -
OFFICE OF MARITIME LABOR AND TRAINING -
NOVEMBER 1983

ENGINE (OCEANS) OFFICERS



[Whereupon, at 11:52 o'clock a.m., the subcommittee recessed subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

JOINT MARITIME CONGRESS,
Washington, DC, March 20, 1985.

Senator TED STEVENS,
Chairman, Subcommittee on Merchant Marine, Committee on Commerce, Science and Transportation, Hart Senate Office Building, Washington, DC.

DEAR SENATOR STEVENS: The Joint Maritime Congress welcomes the Subcommittee's invitation to testify on the Administration's FY 1986 Maritime Administration funding request and S. 102, to authorize funds for construction differential subsidies and to promote a strong merchant marine. We offer the following statement to be included in the hearing record.

The FY '86 Maritime Administration budget is just as scrimping as its four predecessors—enough to carry out present obligations but no more. As much as we disagree with the inadequate funding levels, one cannot ignore today's political exigencies. It is difficult to imagine that any new program requiring large budget outlays will pass a Congress committed to reducing the federal deficit. In this sense of shared sacrifice, we lend our qualified support to the funding levels and urge that legislation be reported out without substantive amendments. Hanging a yoke of divisive proposals around the legislation will accomplish nothing but return us to the days where a MarAd authorization bill could not be passed because of its controversial amendments.

However, as the Administration begrudges the U.S.-flag operator funding, it should not renege on its promise to find cost-efficient solutions to the problems he faces. The most obvious and most needed is permanent authority to build and acquire tonnage abroad. The Joint Maritime Congress cannot see how another Congress can go by without addressing this, the most critical issue, to the survival of the U.S.-flag fleet.

Our association understands the misgivings about foreign acquisition. The JMC is not unsympathetic to the crisis faced by America's shipyards. We have also followed with great interest the various proposals voiced in the past few years to provide work for our domestic yards. Some of them such as Senator Inouye's bill, S. 102, are laudable. It could inject some life into U.S. yards and has our support but only if it provides for full parity in the enormous gaps of cost, construction time and technology. The JMC would like to stress, however, that it is not fair to ask the U.S.-flag operator to stake his very livelihood on what we believe are actions primarily designed to bail out the shipyards. We must constantly remind ourselves that relief for the shipyards is not necessarily relief for the operator. As House Merchant Marine Subcommittee Chairman Mario Biaggi recently observed: "One industry should not hold a sister maritime industry hostage."

It is our fear, however, that the same misperceptions that clouded previous discussions of foreign acquisition will muddy the waters again this year. We can speak about the Mariner Program and series construction until the 100th Congress. Without some sort of subsidy, these plans will not work and it is doubtful even then that parity with foreign yards could be achieved. The result, however, is always the same: the U.S-flag operator is left out in the cold for yet another year. Perhaps U.S. shipyards can afford to wait: many are getting contracts from the Navy. The U.S.-flag operator, on the other hand, is being blocked at every turn when he tries to get the best and least costly equipment to do his job properly. This is no way to do business and we can think of no other industry in America so burdened.

Mr. Chairman, our dilemma is clear: there is no way that a U.S.-flag liner operator can replace his old and fuel-inefficient tonnage in U.S. shipyards without subsidies and still remain competitive. A foreign acquisition program is the obvious remedy. It is by no means the comprehensive maritime program that we have been searching for, but then again, neither was the Shipping Act of 1984. That landmark bill was not intended to cure all the woes of the industry but serves nevertheless a very specific and useful function. So would foreign acquisition. With the immediate threat of extinction removed, we could then move on to craft the larger, unified program that embraces maritime and national security concerns. Build and acquire abroad is the best solution we can find for one problem in a very imperfect world. Mr. Chairman, we must face reality.

The Joint Maritime Congress therefore respectfully urges the members of the Commerce Committee to report a MarAd funding bill out of Committee without amendment and then devote full attention to a resolution of the build and acquire abroad proposal. We appreciate this opportunity to present our views and look forward to working with the Committee to improve the efficiency, competitiveness and size of the U.S.-flag fleet.

Respectfully,

DAVID A. LEFF.

STATEMENT OF VICE ADM. WILLIAM H. ROWDEN, USN, COMMANDER, MILITARY SEALIFT COMMAND

Mr. Chairman, I appreciate the Senate Merchant Marine Subcommittee's invitation to provide a statement in conjunction with your hearing on the Maritime Administration's fiscal year 1986 authorization request and related legislation. The Navy's Military Sealift Command is vitally concerned about the future of the U.S. Merchant Marine because we depend on it as the key source of strategic sealift to deploy and support our military forces in times of war or national emergency.

The U.S. Navy and our nation's maritime industry have long been partners in meeting strategic sealift requirements. But it is clear that the U.S.-flag Merchant Marine has been changing dramatically in both size and character. To maintain a strategic sealift capability worthy of our national security needs, the Navy has undertaken several programs to strengthen its part of the seapower equation. Before reviewing those programs, however, it is important to consider the essential role strategic sealift plays in our national defense, and the condition of the U.S.-flag merchant marine.

The basic strategy of the United States is to deter war through a strong forward defense. In that regard, our strategic sealift programs ar intended to help convince potential enemines that we could react strongly and swiftly to aggression anywhere in the world. Should this strategy of deterrence fail, these same strategic sealift assets, combined with ships of the U.S.-flag merchant fleet, would be called upon to take our nation's military forces to war. Implicit in the "forward defense" concept is the notion that the armed conflict would occur some distance from our own shores.

Under such circumstances, sealift becomes the bedrock of our national strategy. More than 90 percent of equipment and supplies needed to sustain a war effort must be carried by ship. This basic fact has been demonstrated repeatedly in the last 45 years—from the worldwide U.S. convoy and supply operations that were essential to Allied victory in World War II, to the 8,000-mile sealift that ensured British success in the 1982 Falklands conflict.

The U.S.-flag Merchant Marine has long been considered the primary source of ships to meet national defense requirements, but a confluence of factors in the late 1970s and early 1980s spurred a long-overdue reevaluation of its adequacy. These factors inlcuded a series of unsettling events in Southwest Asia—some 11,000 miles from the mainland U.S.—and the continued decline in the number of militarily useful ships in the privately owned U.S.-flag fleet.

It was obvious that new measures would be necessary to ensure sufficient sealift to support a credible deterrent. As recently as last year, the Department of Defense determined that, under certain conditions, our ability to meet the "surge," or initial deployment, requirements of war would be "marginally inadequate" in the future if programs existing in 1983 remained unaltered. Further, the militarily useful capacity of the U.S.-flag fleet was expected to continue declining.

This Subcommittee is well aware of that decline and the myriad reasons for it, including the worst worldwide shipping recession in over 50 years. I will not elaborate on those reasons, but it is important to note the results. Twenty years ago, in 1965, our privately owned marchant fleet totaled 963 ships and only 8 percent were unemployed. By 1975, the number of ships had dropped to 583, with 4 percent unemployed. Today, our privately owned merchant fleet numbers just 502 ships, and a stunning 21.5% are in lay-up. The impact on civilian seafaring employment has been predictable: From nearly 50,000 seafarers in 1965, employment fell to 24,000 in 1975, and 17,000 today.

It is important to note that, meanwhile, the Soviet merchant fleet has enjoyed in unprecedented expansion. In 1965, it had 1,345 oceangoing merchant ships. Today, it has nearly 2,500 and ranks second in the world; the U.S. has fallen to tenth in ship numbers.

Extreme competition in the maritime industry has created pressures for ever-increasing productivity and efficiency. This, in turn, has led to greater containerization of cargo and ever larger ships. But the commercial attributes are sometimes military drawbacks: Their size may prevent access to some ports; much military cargo simply will not fit in standard containers; and shoreside container cranes may not always be available during hostilities. smaller breakbulk ships—although will-suited to military operations—are fast becoming anachronisms.

So we are seeing a steady decline in the number of U.S.-flag merchant ships, and a pronounced shift towards ships that are less militarily useful without modification. Against this backdrop, the Navy has undertaken substantial new programs to enhance the strategic sealift assests under its direct control, and to improve the military usefulness of today's merchant ships. These programs were not entered into on an ad hoc basis, but as an integral part of a much-needed naval rebuilding program.

At the same time that our merchant marine was in decline, the Navy's general purpose forces were being drawn thin by expanding worldwide commitments and a ship retirement rate that exceeded replacements. That situation has been reversed, and the "600-ship Navy" is today becoming a reality through the Navy's aggressive shipbuilding program. The potent combatant ships now joining the fleet will allow the Navy to establish and maintain local superiority in an area of naval operations and project naval power much more effectively.

The Navy's current strategic sealife programs go hand-in-hand with this revitalization of the combatant fleet. As we strengthen our ability to project power—in support of a forward deterrent posture—we need the corresponding ability to deploy and sustain U.S. forces overseas. It is essential that this balance be maintained.

In this regard, it is noteworthy that, since my appearance before this Subcommittee last year, the Secretary of the Navy and the Chief of Naval Operations have formally established strategic sealift as one of the Navy's three primary functions, joining sea control and power projection. In conjunction with this action, administrative and oprational changes have been instituted within the Navy. They ensure that sealife programs will continue to be considered on a balanced basis with competing Navy programs, and that the option of strategic sealift ships is fully integrated into the structure of the Navy's operational fleets worldwide.

More visible have been the programmatic efforts, including the construction and conversion of 75 sealift ships in U.S. shipyards. In addition to these ships, our shipyards are upgrading the more than 70 additional ships to go into the Ready Reserve Force. These ships will be operated by the Military Sealift Command, and will be manned by civilian mariners. Here's a brief status report on some of the most noteworthy of those programs:

First, we deployed cargo-laden ships to distant parts of the world, where they are prepositioned near potential trouble spots, ready to marry-up with airlifted Marines. We established the Near-Term Prepositioning Force in 1980 as a quick and efficient means of achieving dedicated sealift in the Indian Ocean, a region without mainland staging sites for military units. Today, the 17 ships in the NTPF are positioned in the Indian Ocean, Pacific and Mediterranean, and carry enough equipment and supplies to support a Marine brigade, plus material and ammunition for Army and Air Force units.

Second, we developed a follow-on program of Maritime Prepositioning Ships, which are specifically configured to perform this function. There will be a total of 13 Maritime Prepositioning Ships; five hve been delivered to date, and the rest will come on line by March 1986. Whether sailing the world's oceans, or prepositioned near potential trouble spots, they will greatly improve our capability to place military supplies wherever needed on short notice.

The Maritime Prepositioning Ships will be loaded out with a full range of Marine Corps cargo, from ammunition and artillery to water and rations. In all, they will carry enough equipment and supplies to support three Marine brigades for 30 days.

Third, we undertook the conversion of eight large containerships into what we now call Fast Sealife Ships. These former "SL-7s," acquired by the Navy in 1981, will allow us to quickly move large volumes of military equipment from the United States to distant contingency areas. They will be kept in a reduced operating status, but will be capable of being activated and ready to proceed to a loading berth in just 96 hours. Within an additional few days' time, they can be ready to sail with the equipment for a heavy mechanized Army division, for example.

Four of the Fast Sealife Ships have been delivered, and the other four will be delivered in the next 13 months.

Fourth, we started an ambitious expansion of the joint MarAd and Navy Ready Reserve Force, a pool of Government-owned cargo ships that can be activated in either 5 or 10 days, as specified. During 1984 alone, the RRF was expanded from 32 to 55 ships, and this number will soon increase as several recent acquisitions are turned over to the Government. We may expect the RRF to increase to more than 100 ships in the next few years.

It is important to note that the ships in the RRF are not "rustbuckets," but relatively modern, highly militarily useful ships maintained to meet Coast Guard and American Bureau of Shipping standards. They are regularly tested in no-notice breakouts, and used frequently in military exercises.

Fifth, we have begun converting up to 12 ships into crane ships, capable of unloading containerships under a wide range of conditions: in primitive ports with no lift facilities; in modern ports where the container cranes have been damaged by enemy action; or "in stream" without any port facilities. It is an innovative solution to the challenge of making today's merchant ships more militarily useful. The first of these crane ships was delivered last year, and was successfully tested last fall.

Other programs to strengthen our sealift capabilities include the following:

Conversion of two tankers into hospital ships with a combined capacity of 24 operating rooms and 2,000 beds. Work has begun on the first, and the deliveries are scheduled for 1986 and 1987.

Conversion of two roll-on/roll-off ships into aviation logistics support ships, capable of providing maintenance activity for helicopters and fixed-wing planes. Modifications are underway, and both ships will be delivered in 1986.

Construction of five T-5 tankers to replace five aging tankers in the MSC fleet. These 30,000-deadweight-ton clean product tankers will be delivered in 1985 and 1986.

Construction of at least 12, and possibly as many as 18, ocean surveillance ships as part of MSC's Naval Fleet Auxiliary Force (NFAF). Three have been delivered and the remaining nine that have been funded will come on line throughout 1985 and 1986.

Construction of up to 15 TAO-187-class fleet oilers. As part of NFAF, they will deliver petroleum products directly to combatant ships underway. The first four are under contract and will be delivered in 1986 and 1987.

And, enhancements to merchant ships to make them more militarily useful. A major example is the modification of container cells to permit the installation of sea sheds or flat racks capable of handling tanks, artillery and other military equipment.

I think you can readily see the Navy is doing a great deal to enhance our nation's strategic sealift capabilities. As I discussed earlier, these programs have been udnertaken to support our national strategy of a strong forward defense. But a most welcomed "by-product" is that substantial benefits flow to our nation's maritime industry.

Prior to 1980, very little was spent on strategic sealift; in fact, more is being spent on current sealift enhancement programs than in the entire period since World War II. In terms of total Defense dollars, the percentage is very small. But in terms of business for the maritime industry, the impact is significant.

During the period FY 1982-89, approximately $5.4 billion will be spent for new ship construction and coversion under Navy sealift programs. At least eight different U.S. shipyards will share in this work, as will scores of component manufacturers and shipyard suppliers. During the same period, approximately $13.4 billion will be paid to ship operators for the operation and maintenace of sealift ships for the Navy. The new sealift ships also will provide over 1,000 seagoing jobs, and the Navy is considering crewing as many as 30 other ships, now manned by Civil Service employees, with contract mariners.

The Navy recognizes that it is clearly in our interest to support a strong merchant marine because it would provide the primary assets to meet the sealift requirements of war or national emergency. In this regard, we also pursue shipping policies that make maximum use of U.S.-flag ships for the movement of DOD cargo. The last Navy-owned dry-cargo ships and tankers are being put in reserve status and, in 1985, we expect nearly 100 percent of DOD's point-to-point dry cargo and tanker cargo to be moved on privately owned U.S.-flag ships—either as common carriers or under MSC charter.

The Navy's response to the strategic sealift challenge has been broad and emphatic. The United States has gained strength through this response, and will be even stronger when these programs reach completion. However, we must still depend heavily on the U.S.-flag merchant marine to meet our wartime shipping requirements. I know the members of this Subcommittee will agree it would be unacceptable to allow our nation's defense to be undermined by sealift shortfalls.

Despite the current difficulties experienced by the U.S. maritime industry, the long-standing Navy/Merchant Marine partnership must and will endure. It is in the best interests of the Navy, the maritime industry and the United States.

STATEMENT OF JOHN C. COUCH, PRESIDENT, MATSON NAVIGATION COMPANY, INC.

Mr. Chairman and members of the subcommittee, on behalf of Matson Navigation Company, Inc., I appreciate the opportunity to provide our statement for the record on the Subcommittee on Merchant Marine's hearing concerning the FY 1986 authorization of appropriations for the maritime programs of the Department of Transportation. My comments are limited to the Title XI legislation which the Administration will soon send to Congress, as described in the FY 1986 Budget documents which were released on February 4, 1985. Specifically, the Administration would increase the existing annual Title XI guarantee fee to one percent of the outstanding obligation and impose a new five percent fee on both new loans guaranteed and direct loans. Matson is strongly opposed to these unwarranted and unnecessary fee increases.

Matson Navigation Company, Inc. is a common carrier by water whose principal operations are, and for 103 years have been, between ports of the United States Pacific Coast and ports of the State of Hawaii. Matson provides service between Seattle, Portland, Oakland and Los Angles on the Pacific Coast and Honolulu, Kahului, Hilo and Nawiliwili in Hawaii.

We currently have six specialized cargo vessels in our fleet for service between the Mainland and Hawaii which range from five to fifteen years old. In 1982 Matson took redelivery of the SS LURLINE after completing a $41 milion conversion that lengthened this ship by 126 feet and nearly tripled its cargo capacity. The LURLINE's return to service was another step in a $300 milion ship replacement program that Matson began in 1980, which utilized the Title XI insurance or guarantee program.

All of this $300 million investment was financed with our own funds and funds borrowed from or invested by domestic commercial lending institutions or other bond holders at prevailing market interest rates. It was of great assistance in negotiating these various financing packages to use Title XI guarantees. Especially in some of our leaner years, the fact that the federal government would guarantee full payment to the lender of the unpaid principal and interest in the event of default gave us a better bond rating which resuted in more favorable terms and interest rates. Moreover, the federal insurance or guarantee made loans available which may not have materialized otherwise due to the inherent riskiness of the highly cyclical and capital intensive steamship business. In the absence of Title XI, lenders may simply choose to place their finite resources in other more stable and profitable business ventures.

We are continuing to reinvest profits back into the Hawaii trade in the form of new and expanded vessel capacity and the use of MarAd's Title XI loan guarantee program is very much a part of our plans for vessel construction. On January 18, 1985, two new 350 foot barges built at a U.S. construction cost of $12.5 million arrived in Honolulu to carry transshipment containers between Honolulu and the Neighbor Islands in Hawaii.

On August 5, 1984 the Maritime Administration determined the barges were eligible for a Title XI guarantee, and issued a commitment letter, subject to approval of documentation. Further, in accord with our cargo volume forecasts, a proposal was approved by our Board of Directors on February 28, 1985 for increasing our vessel cargo capacity which will require a minimum $48 million capital commitment. Title XI financing would be an essential element in that project.

As a present and future user of Title XI guarantees, Matson has a clear interest in the continuation of this successful government program. We were, therefore, disappointed to see that the President's FY 1986 budget message indicated an intention to propose legislation that may well kill the Title XI program. Specifically, the FY 1986 budget documents state the Administration's intention to increase the existing annual Title XI guarantee fee to one percent and impose a fee of five percent on both new loans guaranteed and direct loans (i.e., advances).

Currently Title XI users pay an investigation fee to cover MarAd's costs of evaluating and administering the project described in the Title XI application, including appraisal of the property offered as security, vessel inspection during construction, and other administrative expenses. Section 1104(f) of the Merchant Marine Act, 1936 sets the maximum investigation fee at one-half of one percent of the principal amount to be guaranteed. MarAd's regulations implementing Section 1104(f) set the investigation fee at $1,000 for the first $300,000 guaranteed plus one-eighth of one percent of the balance (46 CFR 219.15(c)). If MarAd guarantees the eligible portion of Matson's future $48 million reconstruction project, the current investigation fee would be $45,625. This compares to the Administration's suggested fee on new loans of $1,800,000—a $1,754,375 increase.

The Administration further proposes increasing the annual Title XI fee to one percent of the Title XI obligation. Section 1104(e) of the Merchant Marine Act, 1936 not provides for a range of annual guarantee fees between one-quarter percent to one-half percent during vessel construction and one-half percent to one percent after delivery. Comparable to established financing practices, MarAd has interpreted Section 1104(e) as requiring a range of charges which reflects the financial strength of the borrower in terms of the relation of equity to long-term debt in the borrower's financial structure. The fee charged is based on the financial position of the borrower during the most recently ended year, and therefore, reflects the borrower's most current financial position. Since Matson is very sound financially, we have historically been charged the minimum annual fee. The proposed doubling of this fee is unwarranted and unnecessary. With respect to Matson's $48 million vessel conversion, if MarAd guarantees 75 percent of eligible "actual costs", as that term is defined in the Title XI regulations, the Administration's proposal would increase our intitial annual fee from $180,000 to $360,000.

It is important to recognize that Title XI is not a direct laon but only a guarantee on loans from commercial institutions and other bond holders on which Matson must already pay market interest rates. The addition of a full one percent annually plus five percent initially, unrelated to the credit risks involved, will very likely force us out of the Title XI program altogether.

Fortunately, today Matson is in a strong financial position that would enable us to secure vessel financing in commercial markets without Title XI. Even so, the interest rate would undoubtedly be higher because we would have a lower bond rating in the absence of the federal quarantee. This interest rate differential could become quite substantial, especially in a period of economic downturn when the prospects of our continued financial performance could be questioned.

It has cost the government nothing to guarantee Matson's ship financing bonds, and in fact the Title XI program has been self sustaining until most recently. The recent bankruptcies of a few Title XI obligors does not mean that the program should be scrapped or that the cost of participation should be increased to drive out companies with any reasonable alternative. Indeed, if creditworthy companies such as Matson no longer use Title XI, the remaining Title XI portfolio will only deteriorate resulting in a higher percentage of bankruptcies and higher costs to the government of maintaining the probram. Penalizing creditworthy companies in the future will not cure problems from the past.

Moreover, Congress recently approved legislation which was signed into law on October 30, 1984 (P.L. 98-595) which specifically rejected the idea of doubling the annual Title XI guarantee fee to one percent. P.L. 98-595 requires MarAd to continue its current policy whereby the most creditworthy Title XI obligors pay a fee computed on the lowest allowable percentage and the least creditworthy obligors' fees may be computed on the highest allowble percentage. The Senate Commerce Committee report on P.L. 98-595 (Sen. Rept. 98-652) acknowledges that this new statutory language merely clarifies the intent of existing law that the full range of permissible fees be utilized.

There is no justification for the Administration's proposal. With respect to the five percent initial fee, it is inconceivable that this could have any relationship to the cost of investigating and processing a Title XI application. If the proosed fee increases are designed to compensate MarAd for assuming higher risks of bankruptcy in the maritime industry, this issue was also recently addressed in P.L. 98-595. This new law requires the Secretary of Transportation to conclude that a proposed project is economically sound before approving any Title XI loan guarantee. In making this determination, the Secretary must evaluate stringent criteria such as the need for additional equipment in the particular segment of the maritime industry involved, the vessel's market potential over the life of the Title XI guarantee, and projected revenues and expenses associated with employment of the vessel.

Over the years Title XI has greatly assisted us in vessel financing. The program has paid its own administrative expenses. The default rate has been extremely low. It fosters private borrowing—not government borrowing. It encourges investment in ships and capital equipment which are essential to the free flow of the nation's waterborne commerce and national security. The Admiistration's proposed fee increase would be counter-productive and should be rejected.

Thank you for your consideration of our views.

STATEMENT OF PETER J. LUCIANO, EXECUTIVE DIRECTOR, TRANSPORTATION INSTITUTE

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to provide this statement for the record on fiscal year 1986 authorizations for maritime programs of the U.S. Department of Transportation and the Federal Maritime Commission. The Transportation Institute is a nonprofit research and educational organization dedicated to the preservation and promotion of a strong American maritime industry. Our 174 member companies operate U.S.-flag vessels in the Nation's foreign and domestic shipping trades, including the Great Lakes and inland waterways.

The situation our industry faces today is one of continuing erosion. While most of the country has prospered under the resurgent U.S. economy, the U.S. merchant marine has with few exceptions continued its precipitous decline. Federal maritime policy has been ineffective in reversing this decline. If anything, many of the proposed policy changes and cutbacks in government support have further hastened the industry's deterioration. Today, fewer than 400 private, commercial oceangoing U.S. merchant vessels are actively employed in American commerce. Over half of these vessels ply the coastwise domestic trades, while the remainder of the fleet must fight for work in the U.S. foreign trades. In these foreign trades, American vessels still carry only about 5 percent of our Nation's own imports and exports.

None of this, of course, is news to this Subcommittee. The Subcommittee and its members are well aware of the current situation, and have continually made efforts to correct the industry's problems and direct the U.S. merchant marine back up the road to recovery. We commend this commitment, and appreciate the Subcommittee's continuing efforts to adequately fund existing maritime promotional programs, programs which represent our country's longstanding Congressional commitment to a strong and healthy merchant marine. Over the past few years, this support, along with notable efforts by individual committee members to thwart attacks on basic elements of U.S. maritime policy such as the Jones Act and cargo preference laws, has been extremely helpful and timely.

The Transportation Institute also supports full funding of these existing maritime promotional programs. One of the most important responsibilities of any national government is to protect its country from threats to its national security, a vital component of which is a strong commercial maritime capability. However, this capability and security do not come easily or without cost, and a nation must be prepared to develop and sustain it. Other nations of the world have recognized the importance of a stong merchant marine to their economic and national security, and have increased their emphasis on building merchant fleets. Support for these fleets has come indirectly in the form of extensive tax benefits, and directly through substantial government subsidization. Nearly 70 countries also enforce some form of cargo preference policy designed to ensure employment for their national fleets.

The United States, meanwhile, has been moving in the opposite direction, decreasing support for its fleet in the name of free trade. Government programs originally enacted to help American vessels compete against foreign fleets have been eliminated or curtailed, and government cargo preference policies have been repeatedly evaded or ignored by government agencies. It is imperative that the U.S. Government soon reverse this trend and recognize the fact that a free market simply does not exist in the world of international shipping. We must begin developing a viable long-term maritime policy which not only recognizes the reality of today's world shipping market, but also responds with appropriate policies and support programs to revitalize and promote growth in the U.S. maritime industry.

We realize that your task in this endeavor is a difficult one. With the growing concern over the federal budget deficit and increasing pressure for fiscal constraint, implementation of an extensive promotional policy may seem difficult to justify. But when one considers the importance of the merchant marine to national security, these costs become relatively small. Moreover, and more importantly, failure to fund the maritime link in U.S. defenses only serves to compromise the effect of the hundreds of billions of dollars being spent on other U.S. defense efforts, and draw the attention of an able and observant foe.

The Transportation Institute is eager to assist this body in developing a program to revitalize the U.S. maritime industry. As an interim measure, however, we urge full funding of existing promotional programs to help sustain the fleet at present levels and provide a solid base from which to build. We also urge that any modifications made to existing programs before a permanent long-term policy is enacted be constructive in nature, and not destructive. Proposals such as the Administration's plan to increase the annual fee for the Title XI construction loan guarantee program and impose an additional up-front fee of five percent for new loan guarantees and loan advances is without any evident cost-based rationale, and would only act to diminish the attractiveness of the program and further weaken the industry.

This proposal and others like it reflect an anxious willingness to raise additional non-tax revenues at the expense of program effectiveness. Particularly in the case of the Title XI program, such revenue enhancing scheme is wholly without merit. Just last year, Title XI was streamlined to make it much more efficient, and modified to correct any default problems it had previously experienced. The program now costs the government little or no money, and provides substantial benefits to the industry.

While I have this opportunity, I would like to address another issue which, while not directly within the purview of this hearing, is certainly of concern to you because of its impact upon the U.S. merchant marine. Increasingly over the past several years, U.S. maritime policy and the fate of U.S. merchant marine has been dictated not with due and thorough consideration as to how federal policy and program alterations will affect the industry, but indirectly, through modifications made to associated programs by non-maritime Congressional committees, and by political budgetary decisions. The Accelerated Cost Recovery System (ACRS) is such a case. Enacted in 1981, the ACRS significantly decreased the depreciation schedules for most categories of capital expenditures, including the acquisition of merchant vessels, in order to aid U.S. industry in competing against heavily supported foreign competition. For the U.S. merchant marine, the decrease in the depreciation life of merchant vessels from 14 and one-half years to five years has become an important incentive to invest in U.S.-flag shipping, and has proved instrumental in sustaining the U.S. merchant fleet over the past few years. Accelerated depreciation for merchant vessels has facilitated the replacement and modernization of a portion of the active U.S. fleet, and thereby permitted many American operators to remain in business. Without this accelerated schedule, replacement of many old and inefficient vessels would be a much less certain prospect, and the industry would have experienced an even steeper decline than it already has.

Unfortunately, the tax reform legislation recently proposed by the U.S. Treasury Department would scrap the ACRS, and eliminate this important incentive to invest in new U.S.-flag shipping. The stated rationale behind this proposal is a belief that the ACRS has become an ineffective government giveaway that skews domestic investment decisions and wastes the taxpayer's money. Whether or not this is true is certainly subject to debate. For the maritime industry, however, the ACRS has become an effective and essential development policy, countering even more generous foreign depreciation policies. The rationale set forth in 1981 for accelerating the depreciation schedule for maritime is as compelling today as it was then.

Of and by itself, the ACRS comes nowhere close to matching the tax benefits provided by other maritime nations. But by partially offsetting this foreign advantage, it greatly enhances the competitive position of U.S.-flag operations. As highly competitive as the international maritime market is, the reduced costs and increased cash flows which result from the ACRS have been significant enough to help improve the investment climate for American shipping to just above the marginal-risk threshold. This has been enough to cause many investors to consider U.S. shipping over foreign interests. Absent this economic incentive, investment in U.S. maritime assets would be less attractive, and replacement of U.S. merchant vessels to compete in the U.S. foreign trades would be nearly impossible.

Also included as part of the tax reform legislation is a proposal to eliminate tax-deferred Capital Construction Fund (CCF) accounts. These accounts are as important an incentive as the ACRS in replacing vessels in the U.S.-flag fleet. Eliminating this tax deferral of accumulated shipping income would discourage companies from replacing their older vessels with more efficient, internationally competitive ships, and threaten the ongoing modernization of the U.S.-flag merchant fleet.

The questions of whether or not to retain the ACRS and CCF accounts will be an extensively debated subject in this Congress. To the American maritime industry, it will not just be a debate on general national economic policy, but another issue effecting the core survival of the industry. We urge the members of this Subcommittee to work to retain this depreciation and income-deferral treatment as it applies to U.S. maritime.

Thank you.

STATEMENT OF M. LEE RICE, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA

I am M. Lee Rice, President of the Shipbuilders Council of America. The Council is a trade organization representing principal shipbuilders and ship repairers and the suppliers of equipment, materials and services to these industries. A listing of the membership of the Council is attached. I request that our full testimony be included in the record of this hearing.

Mr. Chairman, we will not express surprise, but only concern at the continued lack of authorization for a commercial shipbuilding program in the legislation at issue today.

Our belief that there must be some provision for the shipbuilding mobilization base essential to meet wartime demands is well documented and need not be restated here. We have heard the frequently repeated libels of shipyard inefficiency and high costs from the Administration and others who wish to continue to ignore this growing problem. It is interesting to examine briefly the action of the industry and its critics over the past few years.

The shipbuilding industry can point to its record in the construction of naval ships with considerable pride. Since fiscal year 1981, the naval shipbuilding program has saved hundreds of millions of tax dollars due to shipyard efficiency and lower-than-estimated inflation rates. Many of the major shipyards continue to bring their ships in ahead of schedule and under budget. Since 1983, the cost of major naval ship construction programs has gone down by margins of up to 34 percent as shown in the following chart:

UNIT COSTS BY FISCAL YEAR

[In millions of dollars]

	1983	1984	1985	1986	Current dollars (percent)
Trident	1,384.1	1,848.0	1,777.4	1,547.7	−16.3
CG-47	1,044.3	1,143.8	1,042.3	929.1	−18.8
LSD-41	379.2	364.7	243.0	248.95	−34.3
MCM	92.9	95.3	87.4	83.525	−12.4
TAGOS			64.3	56.95	−11.4
TAO	210.2	174.9	187.5	164.25	−21.9

Note: Fiscal year 1986 is compared to highest unit cost budgeted in prior years.

These savings are achieved by shipyard efficiencies, by application of new technology, and the latest production management techniques. These efficiencies could be translated into reduced commercial ship prices if market conditions were to improve.

Many of these yards which are engaged in the naval program are also engaged in several hundred million dollars worth of capital expenditures to improve their facilities and continue modernization.

Certainly the industry's record is not perfect. It is equally certain that, despite these improvements, American commercial shipbuilding prices far exceed those available abroad. While we continue to struggle with this problem, we are incredulous that the Administration would seek to impose regulatory burdens which significantly increase the cost of a commercial ship in the United States. Yet that is exactly what they propose.

The President's budget submission for fiscal year 1986 proposes, in discussing the Maritime Administration programs, to:

". . . increase the existing annual loan guarantee fee to one percent and impose an up-front fee of five percent on new loan guarantees and advances."

If such cost increases are imposed on the Title XI ship mortgage guarantee program as the Administration proposes the capital cost of an American-built ship would immediately be increased by more than five percent. A significant portion of the costs reduced by shipyard efficiency is thus wiped out by bureaucratic fiat. Those who continue to complain of high U.S. shipbuilding costs should consider carefully the pursuit of such an initiative.

We believe that those who propose this initiative are attempting to raise funds in the Title XI program to cover cost of financing judgment errors previously made. We believe that the Title XI program will be rendered inoperative by such a fee increase.

Our opposition to many of the Administration's other maritime initiatives have frequently been stated and need not be repeated here, with one exception. Those who seek, in the guise of creating "freer markets" and raising revenue, to recoup CDS subsidies in reality do neither but will create a completely disordered market and destroy the only remaining market for commercial shipbuilding market. The CDS repayment initiative which was proposed two years ago remains a constant threat. As you know, Mr. Chairman, the only five major commercial vessels ordered from American shipyards since 1981 are for the Jones Act trades. The two largest ships, the Exxon tankers, are for the Alaskan North Slope oil trade which is the principal object of the CDS repayment initiative. It is a simple fact that Exxon would not have ordered these two vessels if the CDS repayment had been put into effect. The mere fact that this Damoclean sword continues to hang over the Jones Act market artificially depresses that market by sharply increasing the potential shipowners' risk. Further, it is logical that the proposed rule will be extended to dry cargo ships using the same arguments which were the basis of the tanker rule. Thus, the entire Jones Act shipbuilding market may be eliminated. We are hopeful that this ill-advised initiative will be finally and permanently barred by Congress this year.

S-102: CDS AUTHORIZATION FOR FISCAL YEAR 1986

We support Senator Inouye's efforts to obtain reauthorization of the Construction-Differential Subsidy program. His bill, S-102, would authorize $300 million in CDS funds for FY 1986.

When the Administration abruptly ended the CDS program in 1981, American commercial shipbuilding for the foreign trades ceased with equal rapidity. CDS is wrongly maligned as an ineffective program. The truth is that a great many ships were built with it, and virtually none are being built since it disappeared.

Because of the Administration's continued opposition to martime subsidies, we continue to search for a program to replace CDS. We are hopeful that, with the urging of this Subcommittee, industry, labor, Congress, and the Executive can join together to derive and adopt a new program to the benefit of our Nation's security.

CONCLUSION

The shipbuilding industry stands ready to work with the Committee, the Administration, and other elements of industry in developing policy initiatives which can economically, comprehensively, and equitably deal with the elements of the merchant marine to ensure that the resources necessary for national defense are maintained. We are hopeful that, with the spirit of cooperation, the policy stalemate which has plagued industry for so many years can finally be overcome.

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